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Supreme Court, U.S.
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NO. _____

In The
Supreme Court of The United States
October Term 1995

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company,
Plaintiff-Petitioner,

v.

E.W. BLANCH COMPANY, et al.,
Defendants-Respondent.

Petition For A Writ Of Certiorari From The United States Court of Appeals For The Sixth Circuit

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

***William B. Hubbard**
Brenner L. Van Meter
Weed, Hubbard, Berry & Doughty
Suite 2900
Suntrust Center
424 Church Street
Nashville, TN 37219

(615) 251-5444

***Counsel for Petitioner**

LEGAL ADVANTAGE - Advocates in Appellate Services
432 Walnut Street * Suite 200 * Cincinnati, OH 45202
(800) 581-2252

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IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY, by and through David S. Weed, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company,	)	
Plaintiff,	)	
vs.	)	Civil Action
E. W. BLANCH CO., E. W. BLANCH JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, FRANK S. WILKINSON, General Partner, and PAUL S. MAVROS, General Partner,	)	No. 3:90:0581
	)	Judge Echols
	)	Mag. Haynes
Defendants.	)	

PLAINTIFF'S SUPPLEMENTAL MEMORANDUM IN SUPPORT OF PLAINTIFF'S MOTION FOR SUMMARY JUDGEMENT

I. INTRODUCTION

Plaintiff, Cherokee Insurance Company (Cherokee) respectfully submits this

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Supplemental Memorandum in Support of its Motion for Summary Judgment. This memorandum supersedes the previous memorandum filed in support of Cherokee's Motion for Summary Judgment, since it includes Cherokee's original grounds and evidence in support of its Motion for Summary Judgment as well as all supplementary grounds and evidence in support of its Motion for Summary Judgment. This memorandum incorporates by reference all arguments and evidence contained in Plaintiff's Reply to Defendant's Response to Plaintiff's Motion for Summary Judgment and all arguments and evidence contained in its Memorandum of Law in Response to Defendant's Motion for Reconsideration and in Support of Plaintiff's Motion for Reconsideration[1].

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[1]Although this memorandum may appear somewhat repetitive, it is submitted in an attempt to make it easier for both the Defendants and the Court to read and make reference to. The decision to drop Cherokee's claims against Blanch for placement of Cherokee's business with Universal Reinsurance Corporation and

II. FACTUAL BACKGROUND

A. Generally

Defendant, E. W. Blanch Co. ("Blanch") is a professional reinsurance intermediary, organized as a limited partnership under the laws of the State of Delaware, licensed in the State of New York, authorized to do business in the State of Minnesota and doing business in all states. Currently, Blanch has approximately three hundred employees of whom about one hundred are brokers/intermediaries. Plaintiff, Cherokee Insurance Company ("Cherokee"), is an insurance company incorporated and authorized to do business in the State of Tennessee. Cherokee was placed in rehabilitation on July 17, 1984. David S. Weed, Special Deputy Commissioner of Commerce and Insurance of the

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Northwestern National Insurance Company and, furthermore, Cherokee's decision to drop Earl Lanning as an expert witness seemed to make necessary this supplemental memorandum.

State of Tennessee and Rehabilitator of Cherokee brings this action on Cherokee's behalf alleging that from 1980 to 1984 Blanch failed to perform satisfactorily its contract with Cherokee by placing Cherokee's business with financially unsound reinsurers, directly resulting in approximately $1,234,325.00 in ascertainable damages to Cherokee as of December, 1989.

Blanch has filed a Motion for Summary Judgment alleging that the uncontroverted evidence establishes that the reinsurance companies in question were solvent, or generally believed to be solvent at the time the reinsurance was placed. Cherokee moves for summary judgement as to the issue of liability on that grounds that the uncontroverted evidence establishes that Mission Insurance Company ("Mission"), Transit Casualty Insurance Company ("Transit") and Mutual Fire Marine and Inland Insurance Company ("Mutual Fire") were

financially impaired and failed to represent strong security at the time Blanch chose such reinsurers to assume Cherokee's reinsurance risks. Federal Rule of Civil Procedure Rule 56(c) states that summary judgement should issue forthwith if:

> . . . the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter law. A summary judgment interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages. (our emphasis).

Cherokee contends that summary judgement should therefore be granted on the issue of liability since, as a matter of law, a reinsurance intermediary is negligent if it knew or should have known through the exercise of reasonable diligence, of facts or circumstances which would put it on notice

that a reinsurer being utilized to assume a client's risks failed to represent strong security, and, and as a matter of fact, Blanch failed to exercise such reasonable diligence.

B. The Relationship Between Blanch and Cherokee

Reinsurance agreements spread risks among a number of insurers. A reinsurance intermediary, such as Blanch, is a professional who solicits business from the ceding companies (cedents) and transfers or cedes some of the insurance risks of that ceding company to various reinsurers. There is a contract between the ceding company and the reinsurance intermediary, separate and distinct from the contract between the ceding company and each reinsurer. (The contract between the ceding company and the reinsurer is generally termed a treaty.) A reinsurance

intermediary acting with the knowledge, care and skill required by its profession will consistently be:

(a) assisting the ceding insurer in evaluating its reinsurance needs in terms of coverage, capacity, retention, and price;

(b) soliciting, proposing and recommending to the ceding insurer a specifically designed financially adequate, and coordinated structure for its reinsurance program;

(c) adequately investigating the financial solvency of proposed reinsurers.

Vitkowsky, Vincent T., "Status and Obligations of Reinsurance Brokers and Intermediaries in the United States", 265, 274, (Law and Practice of International Reinsurance Collections and Insolvency, 1988) (Exhibit 1)

Blanch served as Cherokee's primary reinsurance intermediary from the late 1960's until 1985. See Deposition of Billy L. Akin. "Akin Depo." (Exhibit 2) Cherokee was a small insurance company lacking the staff and capability of managing its own reinsurance.

See Affidavit of Billy L. Akin, Para. 8, 9, 10. (Exhibit 3) Blanch assured Cherokee of its familiarity with the reinsurance market. See Akin Depo. pp. 330-335. (Exhibit 2) Exemplary of how Blanch represented itself during the time it was ceding Cherokee's insurance risks were the many advertisements in the trade press as well as various brochures it disseminated into the insurance and reinsurance industries. See Akin Depo. pp. 330-335. (Exhibit 2) In the late 1970's one brochure Cherokee received from Blanch stated:

> Thus as a reinsurance intermediary, E.W. Blanch Co. assumes an all-encompassing role, providing sound counsel, designing and negotiating reinsurance programs and placing reinsurance with strong, responsive reinsurance markets. These programs are monitored on a continuous basis with subsequent recommendations for changes which not only reflects client's needs but also reflect availability of new coverages in the reinsurance marketplace. (Exhibit 4)

Cherokee relied on such information and truly trusted its reinsurance needs to Blanch. See Akin Depo. pp. 330-335. (Exhibit 2) Cherokee even had Blanch evaluate reinsurers placed on its business by other intermediaries. See Affidavit of Billy L. Akin Para. 10-19. (Exhibit 3) Billy L. Akin, who was the reinsurance "contact" at Cherokee, describes the communication between Blanch and Cherokee as being extensive during the time Blanch served as Cherokee's reinsurance intermediary. See Affidavit of Billy L. Akin, Para. 11. (Exhibit 3) Mr. Akin recalls the yearly pattern of Cherokee and Blanch's contractual relation as follows:

(a) During August or September, Blanch sent to Cherokee forms to complete, showing current statistical information and projection for the following year's business.

(b) During September or October, Blanch

representatives visited Cherokee to go over the information previously submitted and to analyze the needs of Cherokee for the coming year.

(c) During November and December, other questions from Blanch were handled, suggestions were made regarding reinsurance terms and conditions, and necessary changes in contracts were discussed. At times certain revisions and alternatives would be presented to Cherokee by Blanch.

(d) Near year end, or early in the following year, Cherokee received a confirmation letter, from Blanch explaining terms and conditions of reinsurance contracts. The attached letter of January 7, 1983 is typical of this confirmation.

(e) Any documents requiring signature of Cherokee personnel were usually received several months later, after being executed

by the reinsuring companies.

See Affidavit of Billy L. Akin, Para. 11. (Exhibit 3)

Cherokee was under the impression that Blanch as a professional reinsurance intermediary did whatever was necessary to ensure the reinsurers assuming Cherokee's reinsurance risks were financially viable. See Affidavit of Billy L. Akin, Para. 13. (Exhibit 3) Edward W. Frye. Jr., CPCU, Vice President of Blanch and Steven M. Lonergan, CPCU, Secretary of Blanch who predominantly serviced the Cherokee account were in constant contact with Cherokee. See Affidavit of Billy L. Akin. (Exhibit 3) Blanch, through Mr. Frye and Mr. Lonergan, continually reiterated their expertise in and familiarity with the reinsurance market. See Akin Depo. pp. 330-335. (Exhibit 2) In his deposition, Mr. Akin speaks of the general understanding which existed between Cherokee

and Blanch that Blanch would place Cherokee's business with financially sound companies and companies that would, to the best of Blanch's judgement, represent strong security. See Akin Depo. p. 155. (Exhibit 2) The close association between Blanch and Cherokee justifiably instilled in Cherokee this great confidence in Blanch and its employees.

During the time period at issue in the litigation, 1980 - 1984, the relationship between Blanch and Cherokee appeared to be the same as it always has been. However, in actuality, during this time period, Blanch failed to uphold its assurances to Cherokee and breached its duties to Cherokee. See Akin Depo. p. 348. (Exhibit 2) An intermediary with the resources and reputation of Blanch knew or should have known that the reinsurers being chosen from 1980 - 1984 to assume Cherokee's business were financially unsound. See Affidavit of Bernard L. Webb Para. 10-12 (Exhibit 5.) At

a minimum, given the extensive correspondence and communication between Blanch and Cherokee, Blanch acting prudently should have warned Cherokee or informed Cherokee of any apprehensions it was experiencing regarding the financial condition of the reinsurers. When Blanch placed Cherokee's business with Mission, Transit and Mutual Fire, all of these reinsurers were financially impaired and represented poor security. See Affidavit of Bernard L. Webb, Para. 12. (Exhibit 5) These companies presently owe Cherokee approximately $1,234,325.00 and are not paying because of such financial impairment.

C. The Reinsurers at Issue

1. Mission Insurance Company ("Mission") - Mission originated as a worker's compensation carrier but chose to enter the reinsurance business in 1980. Blanch placed 25% of Cherokee's main working treaty (most heavily relied upon contract

between Cherokee and its reinsurers - "The Combined Property and Casualty Excess of Loss Reinsurance Treaty" - with Mission in 1982. See Complaint paragraph 15; Joint Answer, Para. 14. Then, again in 1983 and 1984, Blanch placed 25% of the main treaty with Mission. See Complaint Para. 15; Joint Answer, Para. 14. At the time Blanch placed Cherokee's business with Mission, Mission was renowned in the insurance industry for underpricing and paying higher than normal commissions. Furthermore, Mission was under-reserving and representing a large percentage of its policyholder's surplus in Reinsurance Recoverables with retrocessionaires of unknown quality. See Charts attached hereto as Exhibit 9. (Retrocessionaires are the reinsurers of reinsurance) Blanch was well aware of Mission's problems. In a Sales and Service Bulletin disseminated within Blanch dated October 29, 1980, the "marketing guide" defined Pacific Re (a subsidiary of Mission

that acted as Mission's managing general agent) as "aggressive and cheap" (Exhibit 6). Mission was financially troubled at the time Blanch placed Cherokee's business with them and Blanch acting as a prudent reinsurance intermediary should have recognized such financial impairment. See Affidavit of Bernard L. Webb p. 12. (Exhibit 5)

According to "Failed Promises, Insurance Company Insolvencies," a Report by the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, U.S. House of Representatives, 105 Congress, 2nd Session, February 1990 ("Dingell Report") (Exhibit 7). Mission's failure was the result of "poor underwriting, severe underpricing, grossly inadequate reserving, accounting gimmicks, false reporting and overall disregard for the well-being of Mission and the constraints of the marketplace." Id at p. 14. Several of the

foregoing factors were easily apparent to the members of the reinsurance industry, including Blanch, and should have indicated the financial troubles Mission was experiencing. An "Order Appointing Liquidation and Restraining Order" was filed February 2, 1987 in the matter of Insurance Commissioner of the State of California, v. Mission Insurance Company. Mission is presently not paying claims due Cherokee as a result of its insolvency. (Exhibit 8)

2. Transit Casualty Company - Transit began doing business in 1945 as a transportation insurance company. In 1978, Transit entered the reinsurance business. Blanch placed 50% of Cherokee's Commercial Umbrella Treaty with Transit in 1983 and again in 1984. See Complaint Para. 15, Joint Answer, Para. 14. As early as 1982, Transit was using reinsurers excessively. In Transit's 1982 financial statement, reinsurance recoverables constituted 179.60%

of policyholder's surplus. (Exhibit 9) According to Cherokee's expert witness Bernard L. Webb, if over 75% of a reinsurer's policyholders' surplus is represented by reinsurance recoverables, the company may be financially troubled. See Affidavit of Bernard L. Webb, p. 13. (Exhibit 5) In such a situation, the Schedule F (a portion of the reinsurer's annual statement) should be examined to determine the quality of the retrocessionaires from which these recoverables are due. See Affidavit of Bernard L. Webb, Para. 13. (Exhibit 5) If Blanch had conducted an examination in 1982, 1983 and 1984 of Transit's reinsurance recoverables relative to policyholders' surplus and had then looked at its retrocessionaires, it would have realized Transit was financially troubled and represented poor security. See Affidavit of Bernard L. Webb, Para. 13. (Exhibit 5)

Transit's failure was not a surprise to

the insurance industry. The Dingell Report pins Transit's failure on problems easily recognizable by the members of the reinsurance industry including Blanch, namely "management incompetence, excessive reinsurance and reckless expansion. . ." p. 31. When Blanch placed Cherokee's business with Transit, Blanch appears to have ignored Transit's problems at Cherokee's expense. Transit is presently in liquidation in the matter of Mary C. Hall, Acting Director, Division of Insurance Department of Economic Development, State of Missouri v. Transit Casualty Company (See Amended Order of Liquidation and Appointment of Permanent Receiver (Exhibit 10). Transit's liquidation has precluded its payment of Cherokee's claims.

3. Mutual Fire Marine & Inland - In 1983 and 1984, Blanch placed 100% of Cherokee's financial guaranty insurance program with Mutual Fire. Mutual Fire

incorporated as a transportation insurance company exclusively. It did not ever enter the reinsurance business until the late 1970's. Mutual Fire was in financial trouble from the moment it entered the reinsurance business. In 1979, Mutual Fire's Annual Statement showed reinsurance recoverables were two and one-half time policyholder's surplus and the figures increased thereafter (Exhibit 9). In a Personal Visit Report compiled by Blanch in January of 1983, following a visit to UMI (Mutual Fire and Inland's management company), Blanch personnel stated:

> An unexpected good visit. We may have the opportunity to increase our position with this company. Adler (A UMI employee) did mention that 1982 is going to look very bad; experience apparently has deteriorated dramatically. There is some concern on my part about the financial viability of this company, if it has to weather very severe financial storms. This is something we need to continually watch. (Exhibit 11)

Mutual Fire was financially troubled and represented extremely poor security in 1983 and 1984 when Blanch placed 100% of a Cherokee treaty with them. See Affidavit of Bernard Webb; Para. 12. (Exhibit 5) In Support of its Motion for Summary Judgment, Blanch contends that Mutual Fire was the only company who would take the financial guaranty treaty on Cherokee's terms. If Mutual Fire was the only company who would reinsure the program, Cherokee was never informed of that fact. See Affidavit of Billy L. Akin, Para. 14. (Exhibit 3) Blanch described Mutual Fire to Cherokee as it did all other reinsurers with whom Blanch placed Cherokee's business - "financially sound" and "good security". See Affidavit of Billy L. Akin, Para. 15. (Exhibit 3) Blanch was negligent in its placement of Cherokee's business with Mutual Fire. Presently, Mutual Fire is operating under a Plan of Rehabilitation in the matter of George F. Grode, Insurance

Commissioner of the Commonwealth of Pennsylvania v. The Mutual Fire Marine and Inland Insurance company. (Exhibit 12) Mutual Fire is not paying Cherokee's claim because of its financial impairment.

II. LEGAL ARGUMENT

A. As a matter of law, a reinsurance intermediary can be held liable for placing reinsurance with financially impaired reinsurers.

(i) Blanch had a duty to analyze the financial security of the reinsurers with whom it place Cherokee's business.

In support of its Motion for Summary Judgment Blanch equates the reinsurance intermediary with the primary insurance broker. Such a comparison is nonsensical. The reinsurance industry is highly complex and is much less regulated that the primary insurance industry. Reinsurance intermediaries dealing with insurers, on the one hand, and the reinsurance market on the

other hold themselves out as very specialized professionals. Unlike the primary insurance broker who merely delivers a standardized policy to the potential policyholder, the intermediary is assuming an "all encompassing role." (Exhibit 4) Primary insurance brokers are basically sales people; their expertise is in the area of policy coverage and analysis of insurable loss exposures. See Affidavit of Bernard L. Webb, Para. 8. (Exhibit 5) Few of them have sufficient knowledge of insurance company finance and accounting to assess the solvency and solidity of an insurer. See Affidavit of Bernard L. Webb, Para. 8. (Exhibit 5) In contrast, Reinsurance brokers/intermediaries must by the nature of their business have an understanding of insurance finance and accounting. See Affidavit of Bernard Webb, Para. 8. (Exhibit 5) Reinsurance is an important element in an insurer's financial planning. See Affidavit of Bernard L. Webb,

Para. 8. (Exhibit 5) A reinsurance intermediary/broker must understand the effects of reinsurance on an insurer's finance and accounting statements in order to assist his clients in the design and execution of a reinsurance program. See Affidavit of Bernard L. Webb, Para. 8. (Exhibit 5) Consequently, the assessment of an insurer's solvency and solidity should not be beyond the abilities of qualified reinsurance intermediary/broker. See Affidavit of Bernard L. Webb, Para. 8. (Exhibit 5)

Other factors indicative of the differences between the primary insurance broker and the reinsurance intermediary are the vast discrepancies in size and premium writing between the two. Most primary insurance agencies and brokerage firms are small. A recent survey of primary agents showed that 93% wrote less than $7 million in premium annually with 72% writing less than

$2.5 million. What It Costs, 1990 Edition, Rough Notes Company, pp. 4-5 as cited in Affidavit of Bernard L. Webb. (Exhibit 5) In the primary agent/insurer relationship, most of the premium income must be forwarded to the insurer - the primary agent of broker keeps only his commission, typically about 15% of the premium. See Affidavit of Bernard L. Webb. (Exhibit 5) At that rate, an agency with $7 million in premiums would have commission income of $1.05 million. See Affidavit of Bernard L. Webb. (Exhibit 5) In contrast, E.W. Blanch Co. had estimated gross revenues (comparable to the commission figure referred to above) of $47.2 million in 1989, with premium volume of $940 million (Business Insurance, November 12, 1990 pp. 3, 10. as cited in Affidavit of Bernard L. Webb, Para. 10) (Exhibit 5)

These differences in the roles of the reinsurance broker and the primary insurance broker are well-recognized by members of the

insurance and reinsurance industries. The courts have discussed such differences as well. In Francis v. United Jersey Bank, 392 A.2d 1233 (N.J. 1978) (Exhibit 13) the Superior Court of New Jersey stated:

> . . . The task of the reinsurance broker is much more complicated and sophisticated than that of the ordinary retail insurance broker with whom we are all familiar in our capacities as owners of automobiles or houses. The insurance companies involved rely to a large extent on the knowledge, skill, integrity and bookkeeping of the reinsurance broker.

Blanch is well aware of the differing levels of expertise between a reinsurance intermediary and a primary insurance broker. Furthermore, Blanch is well aware of the greater degree of care a reinsurance intermediary must exercise in the performance of its activities, than a primary insurance broker. Blanch describes reinsurance as a very risky part of the insurance market. See Depositio of Leo Heifetz p. 60 (Exhibit 14).

Wherefore, Blanch, aware of the nature of the business, has a duty to the clients to act accordingly.

The duty of care of the reinsurance intermediary is specifically confronted in the case of Master Plumbers Ltd. v. Cormany & Bird, 255 N.W.2d 533 (Wisc. 1977). (Exhibit 15) Although the Master Plumber's Court entered a directed verdict in favor of the reinsurance intermediary, the court did not do so on the grounds that no duty existed to determine the financial viability of the reinsurers with whom the intermediary placed the case of Cherokee. Blanch failed to adequately perform such duty, which breach has caused Cherokee great damage. See Bernard Webb affidavit, Para. 11-15.

(ii) Blanch breached its duty to analyze the financial security of the reinsurers with whom it placed Cherokee's business.

Blanch held itself out as a

professional reinsurance intermediary who could evaluate Cherokee's reinsurance needs, gather information about Cherokee to present to potential reinsurers, financially evaluate potential reinsurers and ultimately place reinsurers on Cherokee's treaties. Cherokee justifiably relied on Blanch's familiarity and expertise in the reinsurance realm. It is apparent that Blanch had both the financial and personnel resources to make reasonable investigations of the financial strength of the reinsurers with which it placed Cherokee's reinsurance. See Affidavit of Bernard L. Webb, Para. 10. (Exhibit 5) The uncontroverted facts in this litigation show that Blanch knew or should have known of the financial impairment of Mission, Transit and Mutual Fire.

Despite Blanch's present attempts to minimize its duty to financially evaluate the reinsurers with which it placed Cherokee's business, Blanch set up an internal market

security committee which was formed to establish the financial criteria by which Blanch could analyze potential reinsurers and arrive at an approved list supposedly in an effort to ensure good security for the clients. (See Memo dated September 30, 1980, attached hereto as Exhibit 16) The approved market lists compiled by the market security committee consisted of reinsurers recommended for use by Blanch brokers. A reinsurer's approved market status was determined by a majority vote of the committee. In Sales and Service Bulletin Number 300 dated July 31, 1981 the approved marketing lists were described by Blanch: "Our marketing lists contain reinsurers that we feel offer good security.: (Exhibit 17) The bulletin goes on to state that the use of non-approved markets is a "delicate situation" and to emphasize specific procedures that must be followed in such a "delicate situation." Undoubtedly, Blanch recognized a duty to

evaluate and monitor the financial situation of potential reinsurers or neither the market security committee nor the marketing lists would have been created.

Leo Heifetz, Vice President of Blanch and Chairman of the market security committee from 1981 - 1984, testified that the Market Security Committee looked to certain criteria when determining which reinsurers would be on the approved marketing lists including: (1) staff, (2) size, (3) A.M. Best ratings, (4) NAIC early warning test results and (5) the Reinsurer's Annual Statements. See Deposition of Leo Heifetz, pp. 29-30. (Exhibit 14) If the Market Security Committee had in actuality conducted an analysis using these criteria, Blanch would have easily detected the financial problems of the reinsurers at issue.

The evidence in this litigation demonstrates that Blanch did very little if any independent actual analysis of the

reinsurers with whom it was placing business. Blanch did not test the relationship between reinsurance recoverables and policyholders' surplus for the reinsurers to which business was ceded. See Deposition of Leo T. Heifetz pp. 67, 225. (Exhibit 14) Blanch did not look at the reinsurer's Schedule F (a portion of the annual financial statement which lists the reinsurer's retrocessionaires) to determine if reinsurance recoverables were actually capable of collection. See Deposition of Leo Heifetz, p. 70. (Exhibit 14) If Blanch had examined the relationship between policyholders' surplus and reinsurance recoverables of the reinsurers at issue at the time it placed Cherokee's business, and then looked to these reinsurer's Schedule F's, Blanch would have known the reinsurers were financially troubled and represented poor security. See Affidavit of Bernard L. Webb, Para. 13. (Exhibit 5) Blanch did not test the

relationship between a reinsurers policyholder's surplus and the reinsurer's investment in subsidiaries. If Blanch had looked at the high percentage of policyholders' surplus represented by investments in subsidiaries for Mission, at the time it placed Cherokee's business, and then had analyzed the actual value of the subsidiaries of Mission, Blanch would have known Mission was financially troubled and represented poor security. See Affidavit of Bernard L. Webb, Para. 14. (Exhibit 5)

Blanch places much emphasis on the importance of A.M. Best's evaluation and rating of reinsurer's. If all Blanch, as a professional, was expected to do to check the viability of reinsurers was to look at A.M. Best's evaluation and rating service then they would be being paid for a job any lay person in the industry could perform. All A.M. Best's does is print the narrative and financials provided it by the reinsurer and

give the reinsurer a rating based on such information. Cherokee expected much more from Blanch and Blanch recognized Cherokee's expectations. Blanch recognized in the early 1980's the fallacies contained in A.M. Best's ratings. Heifetz sent a memo to the market security committee dated August 14, 1981 which stated:

> The following markets have a questionable status for any variety of reasons: financial performance, staff, underwriting, attitude, conceivable, their effectiveness and acceptability is masked by an acceptable Best's rating (Exhibit 18).

This memo is indicative of exactly how much deference could be given A.M. Best's evaluating and rating service if a reinsurance intermediary was acting prudently, in the interests of its clients[2].

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[2]If Best's evaluation and rating was the only tool being used by the reinsurance intermediaries at the time, the whole profession would be deemed negligent. Comment §295A of the Restatement Second of Torts recognize that some customs and usages "are the result of careful thought and decision." However, the comment emphasizes

Regardless of the figures and other information provided A.M. Best, Mission, Transit and Mutual Fire were financially troubled and represented poor security at the time Blanch placed Cherokee's business with them; a prudently performed analysis was not done; and, such nonperformance was at Cherokee's expense, causing great damage to Cherokee.

III. CONCLUSION

For the reasons stated above Cherokee

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that "others arise from the kind of inadvertence, neglect, or deliberate disregard of a known risk which is associated with negligence." The comment concludes: "No group of individuals and no industry or trade can be permitted by adopting careless and slip shop methods to save time, effort or money, to set its own uncontrolled standard at the expense of the rest of the community. It follows therefore that whenever the particular circumstances, the risk or other elements in the case are such that a reasonable man would not conform to the custom, the actor may be found negligent in conforming to it' and whenever a reasonable man would depart from the custom, the actor may be found not to be negligent in so departing."

requests that the Court grant Cherokee's Motion for Summary Judgment as to the issue of liability.

Respectfully submitted,

Weed, Hubbard & Berry

By: _____
William B. Hubbard (2770)

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Brenner L. Van Meter (13302)
Third National Financial Center
424 Church Street, Suite 2006
Nashville, TN 37219
(615) 255-1773

CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing Plaintiff's Supplemental Memorandum In Support of Plaintiff's Motion for Summary Judgment has been forwarded by first-class mail, postage prepaid to: Mr. Daniel P. O. Keefe and John

Orenstein, Dorsey & Whitney, 2200 First Bank Place East, Minneapolis, Minnesota, 55402; and hand-delivered to Mr. Jay Bowen, First American Center, Nashville, Tennessee, 37238, on this the _____ day of September, 1992.

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William B. Hubbard (2770)

STATUS AND OBLIGATIONS OF REINSURANCE

Brokers and Intermediaries:

In The United States

Vincent J. Vitkowsky
Nixon, Hargrave,
Devans & Doyle
New York, New York

STATUS AND OBLIGATIONS OF REINSURANCE BROKERS AND INTERMEDIARIES IN THE UNITED STATES

By

Vincent J. Vitkowsky

I. INTRODUCTION

Reinsurance intermediaries[1] play a central and crucial role in the placement and implementation of reinsurance agreements. When disputes arise or reinsurance recoverables are withheld, it is not surprising that the parties involved seek redress from the intermediary, as well as from each other.

There is little case law in the United States specifically addressing the status and obligations of reinsurance intermediaries.

1/ The preferred term in the United States is "reinsurance intermediary". In the United Kingdom, it is "reinsurance broker". For the purpose of consistency, this paper will use the term "intermediary" throughout.

Further, the existing legal precedent fails to resolve the liability issues faced by intermediaries in their dealings with reinsurers nd ceding companies. To resolve these issues, intermediaries and their counsel are forced to rely on the general principles of agency and contract law, the customs and practices of the reinsurance industry, contractual language, case law concerning insurance agents and brokers generally, state regulation, and the inherited and acquired wisdom of professionals in the industry.

II. THE LAW OF AGENCY AS A FRAMEWORK

The courts have addressed issues relating to reinsurance intermediaries in the general context of agency law. Frequently, the determinative question is whether the intermediary acted as agent for the reinsurer, or for the ceding company. Thus, the fundamental principles of agency must be borne in mind.

Under agency law, the acts of an agent are attributable to, and binding on, its principal. Should a court find that the intermediary negligently or intentionally performed incorrect acts as the agent for the ceding company, those acts will be attributed to the ceding company. The reinsurer who suffered injury due to the intermediary's negligence then has a cause of action directly against the ceding company for damages. If the intermediary's negligent or intentionally improper acts damage the ceding company, however, the ceding company cannot sue the reinsurer. Rather, the ceding company is left with a cause of action only against the intermediary. The opposite result follows where the intermediary is found to act as agent for the reinsurer. Thus, the characterization of an intermediary as agent of either the ceding company of the reinsurer has significant consequences.

Several courts have applied agency law

in determining the liability of the parties involved in a reinsurance agreement. IN the leading case of IN re Pritchard & Baird,[2] the District Court for the District of New Jersey affirmed the declaratory judgment granted the Bankruptcy Court below, and held that the intermediary, a bankrupt, acted as the agent of the ceding company.

At the time of its insolvency, the intermediary had retained premium payments it had received from the ceding company, and claims monies it had received from the reinsurer. Both the ceding company and the reinsurer asserted claims against the intermediary's trustee in bankruptcy, while arguing that they retained causes of action against each other.

The district court focused on whether the intermediary acted as the agent of the ceding company or the reinsurer in receiving

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[2]/ In re Pritchard & Baird, Inc., 8 B.R. 265 (D.N.J. 1980).

and transmitting both types of funds. The court reviewed the "manifest conduct of the parties" and found that the ceding company had delegated actual authority to the intermediary and had exercised considerable control over the intermediary.[3] The court held that the intermediary acted as the agent of the ceding company when it retained both the premium payments nd the claims monies.

The ceding company was thus exposed to double liability in paying premiums -- it had previously paid the intermediary, but was liable again to the reinsurer. The act of the intermediary, as agent, in failing to forward the premiums to the reinsurer was attributable to the ceding company, as principal, and the ceding company bore the risk of loss of the funds. Conversely, the ceding company could not sue the reinsurer for recovery of the claims monies, as the

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[3]/ Id. at 269-70.

reinsurer had discharged its obligation by paying the intermediary, the ceding company's agent. The ceding insurer cold seek recovery only against the bankrupt intermediary.

The issue before the Pritchard court alarmed the state insurance regulators who were charged with monitoring solvency. Thus, while the action was pending, the National Association of Insurance Commissioners adopted an insurance company examination rule. The rule provided that credit for reinsurance on an insurer's financial statement would be denied unless the reinsurer bore the risk of an intermediary's failure to transmit monies. As a result, reinsurance agreements typically included "standard intermediary clause", which provides that:

> INTERMEDIARY, INC., is hereby recognized as the intermediary negotiating this contract. All communications (including but not limited to notices, statements, premiums, return premiums, commissions, taxes, losses, loss

> adjustment expenses, salvages, and loss settlements) relating thereto shall be transmitted to the ceding company or the reinsurers through INTERMEDIARY, INC. Payments by the ceding company to the Intermediary shall be deemed to constitute payment to the reinsurers. Payments by the reinsurers to the Intermediary shall be deemed to constitute payment to the ceding company only to the extent that such payments are actually received by the ceding company.

This clause governs the agency issue in only one limited area, the receipt and transmission of funds through the intermediary.

Other court also have addressed the issue of agency. In Calvert Fire Insurance Company v. Unigard Mutual Insurance Company,[4] reinsurers sued ceding insurance companies seeking recession of various reinsurance treaties due to the ceding companies misrepresentation and failure to perform under the contracts. The reinsurer argued

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[4]/ Calvert Fire Ins. Co v. Unigard Mutual Ins. Co., 526 F. Supp. 623 (D. Neb. 1980).

that the ceding company should be held responsible for misrepresentations contained in the solicitation materials prepared by the intermediary and submitted to the reinsurers. The court cited In re Pritchard & Baird, and held that the intermediary was acting as agent for the ceding company in all transactions relating to the reinsurance program, including the preparation of the materials containing the misrepresentations. The court, therefore granted recession.

In another case, Aetna v. Glens Falls,[5] the Firth Circuit held that the intermediary acted as agent for the ceding company in ceding particular policies to certain treaties. The intermediary mistakenly ceded a risk not covered by the treaties, and as a result, the reinsurers were not liable for the loss.

Based on these holdings, some

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[5]/ Atena Ins. Co. v. Glen Falls Ins. Co., 453 F.2d 687 (5th Cir. 1972).

individuals in the reinsurance industry have concluded that the agency issue has been settled -- the intermediary always acts as an agent for the ceding company, unless otherwise provided by contract. This conclusion is too simplistic and hence erroneous. Courts examine the specific facts of each case.

Recently, the District Court for the Southern District of New York denied a reinsurer's motion for summary judgment because a genuine issue of fact existed as to whether the intermediary was an agent for the reinsurer. IN Arkwright-Boston Manufacturing Mutual Insurance Company v. Calvert Fire Insurance Company, et al.,[6] an insurance underwriting manager sued a reinsurer asserted that the certificate was effectively cancelled for non-payment of the premiums,

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[6]/ Ackwright-Boston Mfg. Mutual Ins. Co. v. Calvert Fire Ins. Co., et al, No. 86 Civ. 3898, slip op. S.D.N.Y. (July 14, 1987).

even though the cedent had paid the premiums to the intermediary (again, Pritchard & Baird).

The ceding company argued that the intermediary was agent for the reinsurer, so that the reinsurer would be deemed to have received payment when the ceding company paid the intermediary. The court held that, because there was no express contractual provision concerning the agency relationship, it could make no determination as to the agency issue. The court found that the intent of the parties as to the agency relationship could only be determined by considering extrinsic evidence. This, of course presented a fact question which could only be resolved at trial.

Another recent case discusses the factual inquiry a court must make in identifying an agency relationship. Monarch

Ins. v. Insurance Corp. of Ireland Ltd.,[7] was an action for breach of a reinsurance agreement. One of the issues before the Second Circuit was whether the trial court had erred by failing to charge the jury with a theory of "dual agency." Under New York law, the contract entered into through a "dual agent," i.e., an agent acting for both parties, is "voidable at the option of either party, where the parties had no knowledge of the dual agency and the agent has any discretionary role whatsoever."[8] The Second Circuit held that the trial court properly concluded that the evidence of the alleged dual agency of the intermediary was insufficient to pose a jury question, and therefore, a jury charge concerning the dual agency theory was not necessary.

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[7]/ Monarch Ins. Co. of Ohio Insurance Corp. of Ireland Ltd., 835 F.2d 32 (2nd Cir. 1987).

[8]/ Id. at 36.

It is clear that some contexts within the industry, the intermediary acts for the reinsurer, or primarily for the reinsurer. These include a fronting arrangement in which most of the ultimate risk is borne by the reinsurer; a complex risk in which the intermediary places the insurance and reinsurance simultaneously; or circumstances in which the intermediary transmits inquiries initiated by the reinsurer. It is, of course, relevant that there is no consensus among intermediaries that they are agents at all.

London Market practice provides clearer examples of dual agency or no agency. The operation of a "broker's binder" or "open cover," in which the intermediary had de facto underwriting authority for the reinsurer, provides the most stark example.

Based on the case law and industry practice, a careful inquiry into the relevant facts is required before a determination of

agency can be made. Reinsurance intermediaries should examine and define their relationships with reinsurers and ceding companies by asking: Who initiated the transaction? Who controls the terms and conditions of the reinsurance? Who controls the intermediary with respect to the function involved? How much discretion was the intermediary given? What is the custom and usage in the industry? In sum, a thorough investigation must be completed before a decision can be made concerning the existence of an agency relationship.

III. GENERAL DUTIES OF THE INTERMEDIARY

A point that is frequently overlooked is that there is a separate contract to perform services between the intermediary and the ceding company. This contract need not be in writing; in fact, it rarely is. It is separate and distance from the reinsurance contract, which is between the ceding company

and the reinsurer. The intermediary, although identified in the intermediary clause, is not a party to the reinsurance contract.

This separate contract gives rise to distinct rights and obligations. If an intermediary fails to perform its duties, the ceding company may institute a breach of contract action against the intermediary.

In addition to these contractual duties, the reinsurance intermediary is a professional who must act with the due care demanded of the industry. Hence, there may also be a cause of action in tort, in the nature of professional malpractice, should the intermediary fail to perform its duties consistent with the due care of reinsurance professionals. Both the ceding company and the reinsurer would have tort causes of action against the intermediary.

An excellent paper was presented at the 1987 Spring meeting of the Tort and Insurance

Practice Section of the American Bar Association, by Richard M. ShAw. Mr. Shaw identified the duties of an intermediary by analogy to the duties of an insurance broker. The duties include:

1) To adhere to the authority granted by, and to comply with the instructions of, the ceding company;

2) To keep the ceding company fully and promptly informed of all known relevant and material knowledge and facts; and

3) To exercise the knowledge, care, skill and diligence reasonably to be expected of one engaged in the business of a reinsurance intermediary.

[Mr. Shaw continued:]

The standard of knowledge, care, skill and diligence for a reinsurance intermediary would seem in most situations to include:

a) assisting the ceding insurer in evaluating its reinsurance needs in terms of coverage, capacity, retention and price;

b) soliciting, proposing and recommending to the ceding insurer a specifically designed, financially adequate, and coordinated structure for its reinsurance program;

c) adequately investigating the financial solvency of proposed reinsurers;

d) marketing the reinsurance program

to the broker market to obtain support from the market for the reinsurance consistent with the ceding company's proposed structure;

e) obtaining commitments of support for the reinsurance evidenced by placing slips executed by assuming reinsurers;

f) drafting the reinsurance treaties to correctly and adequately memorialize the agreed upon terms in a legal document satisfactory to both the ceding insurer and all assuming reinsurers; and

g) timely notifying the ceding insurer of any requested reinsurance that was not obtained or of any gaps in or lack of continuity in the current coverage or between the current and former reinsurance coverages.[9]

As discussed in the next section, the principal duty owed by the intermediary to the reinsurer is the disclosure of every material circumstance known to the intermediary, or which should be known to it, at the time of placement respecting the nature, character, and volume of risks to be

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[9]/ Shaw, "The New ISO CGL Claims Made Policy Form and its Implications for the Reinsurance Intermediary," Paper Delivered at Spring 1987 Meeting of the ABA Tort and Insurance Practice Section (May, 1987).

ceded.

Undoubtedly, it will be argued that standards of professionalism give rise to additional duties owed to both parties, such as the prompt and accurate transmission of requests for information, responses, and accounting documents between the parties. In addition, it is sometimes argued that the intermediary has a duty to maintain adequate security, such as letters of credit.

IV. THE INTERMEDIARY'S ROLE IN PLACEMENT

The central function of an intermediary is to present information to the reinsurer respecting the character and nature of the risks reinsured. The intermediary conveys the information both orally and thorough written submissions. As previously noted, the Calvert Fire court held that the intermediary was the agent of the ceding company when transferring such information. The holding of the Calvert Fire court should

apply to the typical placement. Thus, material misstatements by the intermediary would be attributable to the ceding company, and may provide grounds for rescission of the agreement.

In Old Reliable Fire Insurance Co. v. Castle Reinsurance Co. Ltd, v. J.H. Minet & Co., Ltd.,[10] the court addresses the issue of whether the intermediary had fully disclosed the nature and extent of certain business to be covered by the reinsurance treaty. In Old Reliable, a ceding company sued a reinsurer, who in turn sued the intermediary for misrepresentation. The reinsurer alleged that the intermediary had not informed the reinsurer of the nature and extent of automobile physical damage liability business that was to be covered by the treaty. The placing slip and telex

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[10]/ Old Reliable Fire Ins. Co., v. Castle Reinsurance Co. Ltd., 665 F.2d 239 (8th Cir. 1981).

indicated that some automobile business was included, but these documents did not elaborate on the nature and extent of the business. The intermediary argued that the reinsurer should have inquired as to the size of the business covered by the treaty.

The court examined the customs of the reinsurance marketplace and concluded that the standard practice in the industry is for the reinsurer to question the intermediary as to the details of the particular provisions outlined in the placing slip. Thus, the reinsurer has the burden to investigate and examine the nature and size of any business risk assumed by the reinsurer under the treaty.

The author is advised that law in the United Kingdom is more favorable to the reinsurer. There, the underwriter is entitled to assume that the intermediary has made a "fair presentation," i.e., that information which he has not been shown, and

which he has not asked for, does not change the essential nature of the information the intermediary has provided.

The case law in the United Kingdom respecting intermediaries, and reinsurance generally, is much more highly evolved. For example, there is precedent that discusses what kind of information is material, whether subjective or objective intent in underwriting controls, and other matters. Due to the scarcity of American case law, the case law of the United Kingdom is frequently cited and may be given some weight by judges in the United States.

V. MEMORIALIZING THE REINSURANCE AGREEMENT

The intermediary typically prepares placing slips, cover notes, and the formal reinsurance agreement. Disputes arise in this context when there is an error or oversight by the intermediary.

The distinction between a placing slip

and a cover note has important legal consequences. A placing slip is a summary of the essential terms of the reinsurance, which bears the stamp or signature of the reinsurer. It is intended to effectuate coverage pending the drafting and execution of the formal agreement. If, as occasionally happens, the formal agreement is never executed, the reinsurer is bond by the placing slip, and the ceding company can sue the reinsurer directly under the placing slip.

In contrast, a cover note is a document prepared by the intermediary to advise the ceding company that reinsurance has been placed. It is not, however, executed by the reinsurer. Under agency law, therefore, if the formal agreement is never executed, the ceding company may not sue the reinsurer based on the cover note. If the cover note is inaccurate, the ceding company has a claim against only the intermediary.

VI. INSOLVENCY OF THE REINSURER

The inability to realize recoverables occasionally occurs due to the insolvency of the reinsurer. The ceding company, which obviously has not anticipated the insolvency, believes the intermediary is at fault, and seeks recovery from the intermediary. Generally, for such a suit to succeed, there must be unusual facts.

Here, again due to the dearth of case law addressing reinsurance issues, it is necessary to analogize to cases involving insurance brokers and insolvent insurers. Such cases are legions,[11] and in lieu of a detailed recitation , some general principles should be discussed.

The broker is not a guarantor of solvency. Its duties are discharged if it

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[11]/ The magnum opus on this subject is Buckley, Liability of Agents and Brokers for Insurer Insolvencies, Law and Practice of Insurance Company Insolvency, American Bar Association (1986).

uses reasonable diligence to evaluate solvency as of the time of the placement. What constitutes "reasonable diligence" is a factual inquiry in each case. This usually involves lengthy litigation, including a trial.

It difficult to fix liability on a broker, even in primary insurance cases. A striking example is Inco Express Inc. v. Market Insurance Company,[12] a case brought in Washington State Court. In Inco, the broker placed business with a non-admitted carrier, rated a "C+" by Best's Key Rating Guide, an industry reference. An "A" rated carrier was also available. There was no guarantee fund protection. The insurer became insolvent.

Even on these facts, however, the court did not find the broker liable. The court

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[12]/ Inco Express Inc. v. Market Ins. Co, No. 14363-8-I Division One, slip op. (Wash. Ct. App. Aug. 11, 1986).

held that the broker had no duty to assure against "unforeseeable future financial problems in a presently financially sound carrier."[13] Further, the court found no proximate cause, stating that the insured's injury was cause not by the broker's failure to disclose, but by the carrier's "unforeseen financially decline and by [the insured's] unforeseen high physical damage losses."[14]

Similarly, the Master Plumbers Limited Mutual Liability Co. v. Cormany & Bird, Inc.,[15] the court held that a reinsurance intermediary was not liable, so long as it made a reasonable inquiry into the solvency of the reinsurer at the time of placement. The court further opined that the intermediary owed no ongoing duty to monitor

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[13]/ Id. at 8.

[14]/ Id.

[15]/ Master Plumbers Ltd. Mutual Liability Co. v. Cormany & Bird, Inc., 79 Wis. 2d 308, 255 N.W.2d 533 (1977).

the reinsurer, which became insolvent five years after the placement.

It may be argued that the duty of care owed by an intermediary to a ceding company is less demanding then the duty of care owed by an insurance broker to an insured. This is because, unlike an insured individual, the ceding company is a sophisticated corporation which is in a strong position to evaluate the financial condition of the reinsurer. It can be argued that by approving the reinsurer obtained by the intermediary, the ceding company has waived a claim against the intermediary, should the reinsurer subsequently become insolvent.

However, the opposing argument can be made that the reinsurance industry is sophisticated, and intermediaries are highly-skilled, specialized professionals, and thus that intermediaries owe a duty of greater care in their activities than do general insurance brokers.

It is evident that the facts are determinative. For example, if an intermediary places reinsurance with a company not on the intermediary's own "approved" list, this is certainly some indicia of deviation from applicable professional standards of care, and may lead to liability.

Finally, most professional liability errors and omissions policies issued to intermediaries contain an exclusion against claims arising out of the insolvency of any insurance company. This is a practical consideration for those contemplating bringing an insolvency-related claim against a financially-marginal intermediary.

VII. THE INTERMEDIARY AND ARBITRATION

Most reinsurance agreements provide that disputes between the parties shall be resolved by arbitration. As noted above, the intermediary is not a party to the

reinsurance agreement. It is thus not bond by the arbitration clause. Further, the intermediary cannot be joined in an arbitration between the ceding company and the reinsurer; the outcome of such an arbitration is not legally binding on the intermediary. The parties can thus hold an arbitration hearing in which the arbitrator determines that the dispute was caused by the intermediary, acting as an agent for one of the parties. The losing party in the arbitration must then pursue a separate lawsuit against the intermediary, and must re-litigate the issues in the arbitration.

It is possible for intermediaries to vary these rules voluntarily. For business reasons, intermediaries may consent to participate in, or be bond by, an arbitration. IN this author's experience, such consent is rarely given.

VIII. STATE REGULATION

It is usually for a state legislature to issue rules concerning reinsurance intermediaries. As of April 1, 1988, only New York has enacted specific rules governing intermediaries, although California and Texas are considering adopting similar rules. The New York rules are set forth in Regulation 98 of the New York Code of Rules and Regulations.[16] As the courts have not yet had an opportunity to construe the language of this recently-enacted Regulation, and the legislative history sheds little light on the statutory meaning, the actual language of the Regulation should be examined. Regulation 98 provides as follows:

REINSURANCE INTERMEDIARIES

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[16]/ New York Comp. Codes R. & Regs. tit.11, § 32.0-32.4 (1982)

§ 32.0 Introduction

(a) Section 122-a of the Insurance Law was added by chapter 620 of the Laws of 1976, effective September 1, 1976 and was amended by chapter 154 of the Laws of 1981, effective July 28, 1981. Subdivision 8 of section 122-a provides that licensed reinsurance intermediaries shall be subject to expansion by the superintendent as often as he may deem it expedient and that the superintendent may promulgate regulations establishing methods and procedures for facilitating and verifying compliance with the requirements of section 122-a; subdivision 9 of Section 122-a provides that every reinsurance intermediary acting as such in this State shall be responsible, in a fiduciary capacity, for all funds received or collected in such capacity, and shall not, without the express consent of his or its principal or principals mingle any such funds with his or its own funds held by him or it in any other capacity.

(b) This Part is promulgated to implement the provisions of subdivisions 8 and 9 of section 122-a by establishing criteria, methods and procedures for facilitating and verifying compliance with said subdivisions.

§ 32.1 Verification of coverage and disclosure

(a) (1) Where the reinsurance intermediary acts in procuring reinsurance for a licensed ceding insurer or accepting reinsurance for a licensed assuming insurer, such intermediary shall have written evidence from such insurer of authority to procure or accept specified types of reinsurance, and the scope of such authority.

(2) The written evidence shall be executed by a responsible officer of the insurer granting the authority and shall include:

(i) the name of the insurer(s);

(ii) the kinds of insurance;

(iii) the type of reinsurance or retrocession;

(iv) the limits of coverage; and

(v) the effective date when the expiration date of the authority.

(b) When a reinsurance intermediary procures a reinsurance contract on behalf of a licensed ceding insurer,

(1) directly from any assuming insurer or insurers, written evidence must be furnished to the ceding insurer, that the assuming insurer or insurers having agreed to assume the risk; or

(2) from a representative, other than an employee of the assuming insurer or insurers, he shall obtain written evidence from the assuming insurer or insurers of the fact that such insurer or insurers have given authority to the representative to bind risks in their name and the scope of such authority. The written evidence shall be submitted to the ceding insurer.

(c) If the reinsurance intermediary places insurance on behalf of a licensed ceding insurer with an unauthorized reinsurer, which is not an accredited reinsurer or which has not placed adequate funds with the ceding insurer pursuant to

Section 70.7 of the Insurance Law, he shall inquire into the financial condition of the assuming unauthorized reinsurer and in connection with such inquiry disclose such findings to the ceding insurer and make available to the ceding insurer a copy of the most recent financial statement. Notwithstanding the above, the ceding insurer may assume the obligation under this subdivision by releasing the intermediary in writing from his obligations under this subdivision.

(d) Where a reinsurance intermediary acts for a licensed assuming insurer in accepting a reinsurance contract, the reinsurance intermediary shall act only within the authority granted by such insurer and shall promptly notify the insurer in writing of any commitment made on his behalf. If on a bordereau basis, such notification shall be made at least quarterly.

(e) No reinsurance intermediary shall procure a reinsurance contract with one or more unauthorized reinsurers, unless there is provision in such agreement for the appointment by the reinsurer or reinsurers of an attorney kin this State, as the true and lawful attorney of each such reinsurer, upon whom all lawful process may be served in any action, suit or proceeding instituted in this State by or on behalf of a licensed ceding insurer, arising out of the contract of reinsurance.

(f) Every reinsurance intermediary shall make full written disclosure, at the time of negotiations, to the parties to any reinsurance transactions, of:

(1) any control over such intermediary by, or any control by such intermediary over

any of the parties to or any other reinsurance intermediary involved in said transaction and/or any retrocession placed by the intermediary affecting said transaction. For purposes of this paragraph, control means the possession directly or indirectly of the power to direct or cause the direction of the management and policies of such party, whether through the ownership of voting securities, by contract other than commercial contract for goods or non-management services, or otherwise. Control shall be presumed to exist if any person directly or indirectly owns, controls or hold with the power to vote 10 percent or more of the voting securities of any other person; provided that no person shall be deemed to control another person solely by reason of his being an officer of such other person;

(2) any retrocession placed by the intermediary, directly or indirectly, in connection with said transaction including the identity of such retrocessionaires; and

(3) the commissions earned or expected to be earned by the reinsurance intermediary, directly or indirectly, in connection with any retrocession applicable to the original reinsurance transaction.

Such reinsurance intermediary shall amend the original disclosure to reflect any additions involving paragraph (1), (2) or (3) of this subdivision as they may occur.

§ 32.2 Books and records of reinsurance intermediaries

(a) For at least 10 years after expiration of each contract of reinsurance transacted by a reinsurance intermediary,

such reinsurance intermediary shall keep a complete record for each transaction showing.

(1) the type of contract, limits, underwriting restrictions, classes of risks, and territory;

(2) period of coverage, including effective and expiration dates, cancellation provisions nd notice required of cancellation, and disposition of outstanding reserves on covered risks;

(3) reporting and settlement requirements of balances;

(4) rate used to compute the reinsurance premium;

(5) names and addresses of insurers;

(6) rates of all reinsurance commissions including the commissions on any retrocession handled by the intermediary;

(7) related correspondence and memos;

(8) proof of placement;

(9) details regarding retrocession handled by the intermediary, including the identify of retrocessionaires and their percentage of each contract assumed;

(10) financial records, including but not limited to premium and loss accounts; and

(11) copies of the evidence required under Section 32.1 (b) (1) and (2).

§ 32.3 Fiduciary responsibility of reinsurance intermediaries

(a) Every person, firm, association or corporation acting as reinsurance intermediary in this State is responsible as a fiduciary for funds received by such reinsurance intermediary, in such capacity. All such funds shall be held in accordance with the following rules:

(1) A reinsurance intermediary shall deposit funds received in one or more appropriately identified accounts in a bank or banks duly authorized to do business in this State, from which no withdrawals shall e made except for hereinafter specified (any such account is hereinafter referred to as "a premium and loss account"). A licensed non-resident reinsurance intermediary may use a bank not authorized to do business in this State, provided such bank is a member of the Federal Reserve System.

(2) Deposits in a premium and loss account in excess of aggregate funds received but not remitted may be made to maintain a minimum balance, to guarantee the adequacy of the account, or to pay funds due but uncollected (any deposit is hereinafter referred to as "a voluntary deposit").

(3) No withdrawals from a premium and loss account shall be permitted except as follows: for payment or return of premiums, commission due others losses to insurer or other parties entitled thereto, interest, if the principals have consented thereto in writing, the intermediary's commissions, and voluntary deposits, provided that no withdrawal of voluntary deposits may be made if the balance remains in the premium and loss account thereafter is less than aggregate net premiums, commissions due others and losses received but not remitted. In computing aggregate net premiums, offsets

from different principals shall not be permitted.

(4) Deposit of a premium in a premium and loss account shall not be construed as a commingling of the net premium and of the commission portion of the premium.

(5) In the case of the reinsurance intermediary dealing with more than one insurer, maintenance at all times in one or more premium and loss accounts of at least the net balance of funds received but not remitted shall be construed as compliance with this Part, provided that the funds so held for each such principal are reasonably ascertainable from the books of accounts and records of such reinsurance intermediary.

(b) Except as hereinabove provided, a reinsurance intermediary shall not commingle any premium or loss funds received or collected in such capacity with its own funds or with funds held by it as insurance agent, insurance broker or in any other capacity.

§ 32.4 General Provisions

(a) The term reinsurance as used in this part shall apply to all forms of reinsurance coverage.

(b) Before a ceding reinsurer or its representative pays any premiums or fees to any reinsurance intermediary, such ceding insurer shall obtain evidence that the requirements of Section 32.1 (a), (b), (c), (e) and (f) of this Part have been complied with.

(c) The provisions of this Part apply to any person, firm, association or corporation acting as a reinsurance

intermediary in this State.

(d) In the case of insurance agent or insurance broker acting as a reinsurance intermediary in this State, such insurance agent or insurance broker shall be required to maintain a premium and loss account(s) separate from its premium account(s), required pursuant to Regulation 29 (11NYCRR Part 20).

(e) The provisions of this Part shall not apply to:

(1) the manager of a group, association or organization of insurers which engage in joint underwriting or joint reinsurance pursuant to the provisions of Section 186-a of the Insurance Law, provided, such manager applies to and is granted an exemption by the Superintendent; and

(2) underwriting managers designated by Underwriting Members of the New York Insurance Exchange, Inc., provided that:

(i) such designation shall have been filed with the New York Insurance Exchange, Inc. in its register of Approved Underwriting Managers;

(ii) the New York Insurance Exchange, Inc., adopts rules to accomplish the intent and purposes of this Part; and

(iii) this exemption shall not apply to any retrocession handled by such underwriting manager of the New York Insurance Exchange, Inc.

(f) If any provision of this Part or the application thereof to any person or circumstances is held unauthorized by law,

the remainder of this Part and the application of such provision to other persons or circumstances shall not be affected thereby.[17]

Although Regulation 98 allows the parties to alter certain requirements by written consent, such consent does not affect or eliminate the common law standard of due care. Thus affect or eliminate the common law standard of due care. Thus even if the parties waive the requirements of Regulation 98, the intermediary may be found liable for negligence. The parties must also ensure that exculpatory clauses are enforceable.

IX. RECENT CASE LAW

A recent case discusses the attorney-client privilege in the context of a breach of contract and negligence action commenced against a reinsurance intermediary. In Baltica-Skandanavia Insurance Company, Ltd.

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[17]/ Id.

v. Booth, Potter, Seal & Co., et al., [18] the intermediary inadvertently produced during discovery a telex discussing a developing dispute under a retrocession placed by the intermediary. The court found that the communication was privileged because: a) it concerned legal advice; and b) an employee drafted the telex for the general counsel's review in his capacity as a lawyer, and not as a business advisor.

The court then ruled that the privilege was not waived by inadvertent production, so long as reasonable precautions were taken to prevent production of privileged documents. The court concluded that the document was produced because of negligence, rather than reckless or willful disregard for precautionary measures. The court emphasized that the privilege protects communications

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[18]/ Baltica-Skandanavia Ins. Co., Ltd. v. Booth, Potter, Seal & Co. et al, No. 86-1967, E.D.Pa. (Slip op. October 15, 1987).

only, and not underlying facts, so there could be discovery concerning the transactions at issue, even though certain underlying facts were the subject of the privileged telex.

Interestingly, the retrocession agreement was made with Transit Casualty Company ("Transit"), an insolvent insurance company that could not be joined in this action because of its affairs were under the supervision of a state court in Missouri. The intermediary argued that Transit was a necessary party in whose absence the action could not proceed. In an earlier decision,[19] the Baltica-Skandanvia court ruled against the intermediary and allowed the action to proceed without Transit, and against the intermediary.

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[19]/ Baltica-Skandanavia Ins. Co., Ltd. v. Booth, Potter, Seal & Co., et al, No. 86-1967, E.D.Pa., (Slip Op. September 15, 1986).

X. CONCLUSION

The character of relationships within the reinsurance industry has changed dramatically in recent years. Disputes have developed with much more frequency. By the nature of their roles, intermediaries are usually embroiled in such disputes. Intermediaries must adhere to the requirements of case law, state regulations, customs and practices of the industry, and inherited wisdom, or they will fund themselves adding to the body of law and acquiring wisdom.

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY Plaintiff, VS. E.W. BLANCH CO., E.W. BLANCH, JR. General Partner MICHAEL W. CASHMAN, SR., General Partner, FRANK S. WILKINSON, General Partner and PAUL S. MARVOS, General Partner Defendants.	)	CIVIL ACTION NO. 3 90 0581 Volume I Pages 1-197

Deposition of:

BILLY L. AKIN

Taken on behalf of the Defendants

October 9, 1990

APPEARANCES:

For the Plaintiff:

William B. Hubbard, Esquire
Brenner B. Lackey, Esquire
Suite 2006 - 424 Church St.
Nashville, Tennessee 372190

For the
Defendants: Daniel P. O'Keefe, Esquire
Juan C. Basombrio, Esquire
Robert M. Benjamin, Esquire
2200 First Bank Place East
Minneapolis, MN 55402

SIMMONS & COMPANY
Post Office Box 3014
Nashville, Tennessee 37219-0014
(615) 865-7919

A That's the same thing.

Q Are we talking about proposed reinsurers or reinsurers who have already contracted to provide the reinsurance where you're just being told after the fact?

A Contracted to handle the reinsurance.

Q Was that a process that was acceptable to you?

A Yes, sir.

Q Did you ever give Blanch my instructions as to the characteristics of the reinsurers that they should be seeking for your business?

A In what sense, "characteristics"?

Q Any criteria that those reinsurers should possess.

A Yes, sir.

Q Were these criteria set forth in writing or verbally?

A The criteria that I had in mind was just the general understanding that I had

with blanch that they would place our business with financially viable companies and companies that would, to the best of their judgment, be that way and exercise their professional abilities in that regard.

Q Did you ever instruct Blanch as to any

proposals to competing intermediaries' proposals?

A I feel that the assistance that Blanch gave to us in making an analysis and comparison with programs was more than would normally be done by an intermediary.

Q Other than that one situation, did Blanch assume any functions beyond those normal and customary within the reinsurance brokerage industry?

A The only other possibility of an item that would fall into that category was Blanch arranging for our cut-through endorsements. I'm just not familiar if that would be usual

and customary. That certainly appeared to be very desirable and very good action on their part.

Q Were there any other functions assumed by Blanch that were not customary?

A Not that I can recall.

Q Did Blanch assume any obligations to analyze the financial strength of reinsurers beyond the ordinary and customary obligations of reinsurance intermediaries?

A In some of its promotional materials and in its advertising in general, Blanch always held itself out to be a company that gave a great

deal of study and thought to where it placed the reinsurance.

Q Are you describing these brochures that re in the files of Cherokee?

A Including those, yes, sir.

Q. Is there anything in addition to those

that you have in mind?

A Only the general reputation that Blanch had in the industry as being in many ways the front runner as far as a desirable intermediary was concerned. And in that sense, perhaps they held themselves out to a greater degree than some of their competition.

Q Other than having a reputation of being a good reinsurance intermediary, did Blanch ever indicate to you that they were willing to assume obligations in analyzing the strength of reinsurers above and beyond any obligations that may exit for reinsurance intermediaries in general?

A I think my same answer would apply. They simply held themselves out to be, certainly in their minds, the best and that they would do the best job that they could. IN other words, their advertising, I think, from their point of view indicates that they felt they were the best

intermediary.

Q And through our capitalist society, there are companies who like to hold themselves out as being the best. And my question to you is whether, other than that type of alleged advertising or promotional material, Blanch ever made any representations to Cherokee reinsurers in some manner different from what was customary within the reinsurance intermediary field.

A Both verbally and in writing, Blanch would state that they had analyzed certain companies, that it appeared to them that they were financially strong. I do not know of them specifically saying other intermediary would not do this also. But I'm simply stating what they have indicated to us, both verbally and in writing.

Q I'm interested in whether you have any basis for testifying one way or another on whether the obligations Blanch agreed to

assume with respect to analyzing reinsurers was more or lest stringent than the standards within the reinsurance intermediary field in general.

A I can't think of anything else to add.

Q Well, do you consider yourself to be in

a position to testify under oath with reasonable certainly that blanch, in fact, assumed obligations of a more stringent nature than was customary within the reinsurance intermediary field?

A It seems to me that Blanch, in its advertising and in its promotional material, would indicate that they would do more or attempt to be better than their competition.

Q Is it your testimony, sir, that you have a recollection of reviewing promotional material where Blanch represented that it would do a more detailed or in depth analysis of the strength of reinsurers than its

competitors?

A No, sir. I did ont mean to testify, if I did, that they made a comparison of their duty to another's duty.

Q Well, that's what I'm, trying to explore, is whether you are in a position to provide testimony under oath of a comparative nature as to whether the obligations Blanch assumed with respect to analyzing the financial strength of reinsurers was greater or lesser than the obligations customarily assumed in the reinsurance intermediary field.

A I suppose we're having trouble with what is meant by a comparison.

Q Well, is that a word that you're unfamiliar with?

A NO. But we're having difficulty of a meeting of the minds as to how you intend it. Let me make a statement that, maybe, will

clarify it, and it's the same thought I previously had: Blanch held itself out, in my way of thinking, in its materials to be -- at least, in their mind -- the best. And if they help themselves out to be the best, then, in one way of using the term "comparison", they were saying they were better than anyone that wasn't the best. But I also said that I saw no material where they listed intermediaries that they felt were specifically any better or any worse than they. And I hope that helps clarify my understanding.

Q These promotional materials are in the files of Cherokee and have been produced to blanch; isn't that true?

A Yes, sir, to my knowledge, they have been produced by Blanch.

Q No let's set those aside for a moment. Those documents will be available and will speak for themselves.

Other than those promotional materials,

did Blanch ever make any representations to Cherokee that Blanch was willing to assume greater obligations with respect to analyzing the financial strength of reinsurers than was customary within the reinsurance intermediary field?

A I cannot say

Q Can you think of any instances where Blanch made any such representations to Cherokee?

A I cannot mention an specific time or place where they made such representation.

Q Can you think of any instance where they did so regardless of the time or place?

A Not specifically, no, sir.

Q Do you have any general recollection of any such representations being made by any representative of E. W. Blanch Company?

A I don't have that recollection.

Q Did you ever discuss with E. W. Blanch company the brokerage Blanch was receiving

from the reinsurers on Cherokee reinsurance contracts?

A Not that I recall.

Q Do you, in fact, know what that brokerage rate was?

A No, sir.

Q Was that ever a subject of any negotiations

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY Plaintiff, VS. E.W. BLANCH CO., E.W. BLANCH, JR. General Partner MICHAEL W. CASHMAN, SR., General Partner, FRANK S. WILKINSON, General Partner and PAUL S. MARVOS, General Partner Defendants.	)	CIVIL ACTION NO. 3 90 0581 Judge Nixon Mag. Haynes

AFFIDAVIT OF BILLY L. AKIN

Billy L. Akin, having been duly sworn according to law states as follows:

1. I am presently employed as president of Professional Consultants & Services, Inc., 2720 Fortland Drive, P.O. Box 60408, Nashville, Tennessee 37206. Although I hold the title of Vice President of Tennessee Underwriters, Inc., and excess and surplus lines broker, I am a licensed

property and casualty, life and health independent insurance agent in the state of Tennessee, and write a small amount of direct insurance business.

2. My education consists of a Bachelors of Science degree from David Lipscomb University with a major in business administration. I have also received the Charter Property and Casualty Underwriter (CPCU) designation, as well as the Associate in Risk Management Diploma (ARM). In addition, I have taken courses at Vanderbilt University Graduate School of Management as well as various technical land management seminars and courses.

3. From 1955 until 1984 I was affiliated with Cherokee Insurance Company of Nashville, Tennessee (Cherokee). While with Cherokee I worked in many areas of the company, starting in the Agency Accounting Department and progressing through the Underwriting and Marketing Departments. By

1984 I was Senior Vice President of Administration, Secretary of the Company and a member of the Board of Directors.

4. From 1978 until Cherokee was placed in receivership in July 1984, my duties included the following: supervisor of administrative affairs, personnel manager, underwriting/marketing consultation and support, preparing and filing of special policies and forms, trade and business organization representative, state insurance department liaison, certificate of authority filings, as well as supervisor of reinsurance. After Cherokee was purchased by the Dana Corporation in 1981, I served as liaison between the company and the parent corporation.

5. After Cherokee entered voluntary rehabilitation in July, 1984, I became secretary of the R&H Service Corporation, an insurance advisory company. This company assisted the State Insurance Department and

the rehabilitator, in the early stages of Cherokee's rehabilitation. In 1985, I worked, on a part-time basis, as Owner and President of Progress Unlimited, a management, sales training and personal development company. While continuing consulting on a part-time basis, I became affiliated in 1986 with Tennessee Underwriters Inc., In 1987 I commenced insurance and reinsurance consulting on a full-time basis. This continues to the present, my joining Professional Consultants and Services, Inc. as President June of 1990.

6. Cherokee primary business was the writing of property and casualty insurance through independent agents, primarily in the eastern United States. As an aside, the company also assumed some reinsurance business. This involved accepting a portion of risks from other insurance companies, for a part of the premium. This activity was outside of the normal scope of Cherokee's

operation, and was handled, almost entirely, by an underwriting manager, Mr. Robert Schirmre, President of New Orleans Reinsurers, Inc., of Metairie, Louisiana. Mr. Schirmer had contractual authority from Cherokee to accept and underwrite assumed reinsurance business, as well as to place retrocession on this business. A retrocession is the reinsurance placed on reinsurance. Cherokee only retained a small part of its assumed reinsurance, and passed the majority of the business to retrocessionaires. Universal Marine Insurance Company of Bermuda (UMIC) acted as the major retrocessionaire. This assumed reinsurance grew out of an agreement by the Chairman of Cherokee David Wilson, with officials of the Ingram Corporations in the late 1970's for Cherokee to "front" for UMIC, Cherokee, UMIC was able to assume risks in the United States without being a licensed United States carrier.

7. It is my opinion that Cherokee was

forced into voluntary rehabilitation by problems resulting from its assumed reinsurance business. UMIC, starting in late 1983, either could not or would not fulfill its obligations toward Cherokee, to pay present and future claims. Cherokee was left with the potential of sever financial loss for many years. Cherokee was obligated to pay 100% of the claims even though UMIC had reinsured a majority of the risks and had received a proportion of the premium. At this point, Cherokee's parent, the Dana Corporation, financially abandoned the company, forcing Cherokee's directors to seek protection from the Department of Commerce and Insurance. The Company was placed into rehabilitation for the good of the insureds under Cherokee's direct business, and other legitimate creditors.

8. As mentioned, while at Cherokee, I worked with the company's reinsurance programs. Being a relatively small company,

for the purpose of sharing risks, Cherokee ceded a large part of its business to reinsurance companies. Cherokee's ceded (or outgoing) reinsurance was handled by reinsurance intermediaries ,primarily E. W. Blanch Company of Minneapolis, Minnesota (Blanch). Other intermediaries used, to a much smaller degree, included Seibels Bruce (presently Southern Intermediaries) of Columbia, South Carolina, G. L. Hodson of Atlanta, Georgia and Fairway Intermediaries of Hamilton, Bermuda.

9. From around 1978 forward I was involved with the ceded reinsurance of Cherokee, to a larger degree than prior to this time. I physically maintained the reinsurance treaties, and kept them current. I participated in most of the discussions with Blanch regarding Cherokee's reinsurance except as regards claims and accounting matters. Also involved in Cherokee's assumed reinsurance business were the Company's

Chairman, President, Claims Vice President and Treasurer. ON occasion, these individuals would interact with blanch in connection with Cherokee's ceded reinsurance program. However, I normally acted as the "contact" person, receiving various requests from Cherokee personnel regarding Cherokee's reinsurance needs, and transmitting the requests to Blanch. In addition, I received from Blanch and disseminated to Cherokee personnel reinsurance requirements and provisions that would effect the underwriting and production of business.

10. Due to its size, lack of expertise, and other responsibilities of personnel, Cherokee relied on its reinsurance intermediaries for design of the reinsurance program, for direction in writing types of business that could be properly reinsured. All Blanch representatives and staff were held in highest professional regard by the management of Cherokee. Blanch was always

perceived as highly competent and professional organization with procedures and personnel in place to thoroughly analyze potential reinsurance markets for Cherokee, including the reinsurer's financial strengths.

11. Cherokee maintained regular and frequent contact with blanch by personal visits from Blanch representatives nd by telephone, postal services, and telex. In addition, the following procedure was customarily followed in each renewal cycle of Cherokee's reinsurance:

(a) During August or September, Blanch sent to Cherokee forms to complete, showing current statistical information and projection for the following year's business.

(b) During September or October, Blanch representatives visited Cherokee to go over the information previously submitted and to analyze the needs of Cherokee for the coming year.

(c) During November and December, other questions from Blanch were handled, suggestions were made regarding reinsurance terms and conditions, and necessary changes in

contracts were discussed. At times certain revisions and alternatives would be presented to Cherokee by Blanch.

(d) Near year end, or early in the following year, Cherokee received a confirmation letter, from Blanch, explaining terms and conditions of reinsurance contracts. The attached letter of January 7, 1983 is typical of this confirmation. (Exhibit A)

(e) Any documents requiring signature of Cherokee personnel were usually received several months later, after being executed by the reinsuring companies.

12. Throughout the process of handling reinsurance for Cherokee, Blanch selected the reinsuring companies that they felt were appropriate for Cherokee's needs. After Blanch negotiated with the reinsurers, Cherokee would be advised as to the companies selected and asked if there were any problems or questions. This is demonstrated in the attached letter of September 30, 1983. (Exhibit B) Cherokee relied on Blanch's selection of the companies.

13. Cherokee was under the impression

that Blanch did whatever was necessary to insure that companies used for Cherokee's reinsurance would be financially viable. This impression came from consultant discussions with Blanch personnel, and statements such as the ones made in the attached letter of October 21, 1981. (Exhibit C) It was unusual for blanch to approach Cherokee concerning a specific company, as set forth in this letter. In this case, as in other cases, Cherokee relied on recommendations of Blanch personnel.

14. To my knowledge, the first written criteria involving reinsurance security between Blanch and Cherokee was a draft of the attached letter of November 17, 1983. (Exhibit D) My recollection is that Cherokee was contacted by Blanch personnel and asked to prepare a letter such as this one, to comply with certain regulations in the reinsurance industry. It is my recollection that basic wording was supplied by Blanch,

and Cherokee was requested to reproduce the letter on Cherokee letterhead. I do not know if it was ever signed by Cherokee. One of the reasons for my recollection regarding the construction of this letter is based upon my belief that Cherokee personnel were not capable and/or never researched these matters anywhere near the extent necessary to elaborate on such specific requirements as set forth in the letter. Again, Cherokee relied upon Blanch to determine the appropriate criteria. Furthermore, Cherokee did not have the documents available to it to make judgments on determination regarding the financial stability of the reinsurers, these were maintained by Blanch.

15. Throughout its association with Cherokee, Blanch obtained as much information as possible regarding the over-all operation of Cherokee. Blanch personnel visited with and corresponded with members of the underwriting and production staff, as well as

claims and financial personnel. This is demonstrated by remarks made by Edward Frye in memorandum of August 24, 1982 to Bidwell, et al. (Exhibit E) In this way, Blanch was able to offer helpful suggestions to Cherokee regarding classes of business which it could or should write, in view of reinsurance availability. Cherokee valued the advice of Blanch in regard to the availability of adequate and financially stable reinsurance, when deciding whether or not to become involved in new programs of insurance. Programs, such as the financial guaranty business, were entered into only when Cherokee did not have the financial capability to act without reinsurance. During the time Blanch was placing reinsurance on the financial guaranty business, to my knowledge Blanch never indicated to Cherokee that Mutual Fire Marine and Inland was the only company that would reinsure this type of business,s or that

Mutual Fire was questionable, from a security standpoint. Blanch described Mutual Fire to Cherokee as did all other reinsurers with whom Blanch placed Cherokee's business, "financially sound" and "god security." At other times, upon advice from Blanch that reinsurance was difficult to obtain, Cherokee would be guided in the writing of certain classes of business.

16. Substantial Claims for outstanding balances due Cherokee have been made by Cherokee with the proper officials acting for or on behalf of: (1) Mutual Fire, Marine & Inland Insurance Company, (2) Transit Casualty Insurance Company, and (3) Mission Insurance Companies. Claims for the balances due Cherokee by: (1) Universal Reinsurance Company and (2) Northwestern National Insurance Company have been made by Blanch on behalf of Cherokee in normal course of business. Also, request for payment has been made to Universal Reinsurance via Blanch by

Cherokee. None of the companies have paid.

17. The large degree of confidence and reliability placed in Blanch by Cherokee was demonstrated when, during the latter part of 1983, Blanch personnel were asked to assist Cherokee in the analysis of proposals of competing intermediaries. Cherokee's top management had asked, as a matter of god business practices, for competing quotes to be obtained from other intermediaries, with possible consideration of replacing Blanch. The attached memorandum of December 7, 1983 gives the recommendations that President Rymand and I made to Chairman Fred Kitchens regarding this matter. (Exhibit F) The memorandum elaborates on Blanch's analysis of the proposal and some of the reasons for our confidence in blanch.

18. Cherokee respected the opinion and reliability of Blanch's evaluation of the financial stability of reinsuring companies so much that it would even ask Blanch to

comment on companies being used by other intermediaries. An example of this is shown in the attached letter of January 28, 1981 to Mr. Edward Frye from Billy L. Akin with copy of record of telephone response. (Exhibit G) Another example is referred to in the fourth paragraph of the second page of Blanch's Personal Visit Report of April 5, 1984. (Exhibit H)

19. For several years one of my duties at Cherokee was to compile information about the company and send it to A. M. Best Company for publication by Best. To my knowledge, A. M. Best never investigated or questioned Cherokee concerning information or statistic submitted. Specifically, the narrative about the company and its operations would be printed by Best verbatim as supplied by Cherokee. I presume this practice is followed by Best with all of the companies on which it makes reports.

20. Blanch was aware that Cherokee

relied upon it to place Cherokee's business with financially secure companies. Blanch never indicated to Cherokee that Cherokee should have a financial analysis made of the companies being selected by Blanch as Cherokee's reinsurers. To my knowledge, Cherokee never asked Blanch to change a reinsurer because Cherokee was not comfortable with the security it offered. When Blanch presented its annual program to Cherokee, it stated that it believed the companies offered good security. Blanch presented itself to Cherokee as an entity that was knowledgeable of the reinsurance area with the capability of judging the quality of the coverage being offered. Cherokee relied upon Blanch's judgment.

BILLY L. AKIN

STATE OF TENNESSEE:

COUNTY OF DAVIDSON:

Sworn to and subscribed before me this 30th day of September, 1991.

_____

NOTARY PUBLIC

My Commission Expires: _____

E.W.Blanch Co. enjoyed steady uninterrupted growth during the 1970's while building a strong foundation for future progress. Consequently, we enter the decade of the 1980's with optimism and confidence, committed-as we always have been - to quality service and fiscal integrity.

Quality service can only be achieved through talented people, and the talent at E.W. Blanch Co. extends across the board. From brokers to contract writers to treaty accountants to claims analysts, our people are knowledgeable, experienced reinsurance professionals. And teamwork makes them even better. Our people work together, combining their individual capabilities with those of other staff members for maximum performance on every project, from start to finish.

During 1979, we continued to strengthen our staff by adding new people, promoting others and realigning certain areas of responsibility. In addition, we improved and expended our administrative capabilities by computerizing a number of processing and reporting functions.

We also continued to expand geographically encouraged by the excellent feedback we received following the opening of our Chicago office in 1978. Our New York and Atlanta offices turned in strong performances in 1979 and will greatly enhance regions of the country in the future.

Our objectives for further growth and progress remain basically the same. We will continue to expand judiciously not for the sake of expansion but with the goal of providing better reinsurance services and the best possible work environment for our employees. We will continue to maintain

strong fiduciary controls and funds handling practices. We will continue to provide innovative and effective program design, timely marketing and prompt, accurate administrative services. In short, we will continue to operate professionally with quality and integrity foremost in mind.

On my behalf and that of my associates, I want to thank our old clients for their continued loyalty, our new clients for their demonstration of confidence and our reinsurance markets for their expertise and cooperation. We look forward to continuing to work with you in the future as new challenges and opportunities arise.

Minneapolis

E.W. Blanch Co. is an internationally known reinsurance brokerage firm officed in Minneapolis, Chicago, New York, and Atlanta. Founded in 1957, the Company provides a full range of reinsurance services to clients who vary in size from small local insurance companies to large international insurance and reinsurance groups.

Minneapolis, site of the corporate headquarters, house four sales and service groups as well as the facultative department and technical services division.

Three Minneapolis sales and service groups under the direction of John Jamieson, John Collins, and Mike Cashman, are engaged in property ad casualty treaty reinsurance. The fourth group, directed by Dick Swager, specializes in life/accident and health reinsurance which is a significant and rapidly growing segment of Company operations. In order to provide maximum service, the Company utilizes the account

executive system to compile the advantages of personal attention with in-depth technical support. This dual effort accommodates clients' requirements for innovative and tailored solutions to their reinsurance needs while providing attentive, effective follow-through.

The facultative department provides prompt service on an individual risk basis. As underwriting manager for two major U.S. reinsurers, this department can immediately bind many property and casualty submissions, as well as issue semi-automatic facultative agreements. These "in-house" advantages are supplemented by brokerage capabilities which give clients access to the coverage and capacity available in the international marketplace.

The technical services division provides contract writing, accounting and claims support to production people in Minneapolis and branch offices. The Company drafts and secures executing of the reinsurance contracts collects and remits premium and loss balances, and compiles statistics for both the client and the reisurers. Career specialists in each of these critical areas are assisted by computer technology.

Thus as a reinsurance intermediary, E.W. Blanch Co. assumes an all-encompassing role, providing sound counsel, designing and negotiating reinsurance programs, and placing reinsurance with strong, responsive reinsurance markets. These programs are monitored on a continuous basis which not only reflect clients' needs but also reflect availability of new coverages in the reinsurance marketplace.

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY Plaintiff, VS. E.W. BLANCH CO., E.W. BLANCH, JR. General Partner MICHAEL W. CASHMAN, SR., General Partner, FRANK S. WILKINSON, General Partner and PAUL S. MARVOS, General Partner Defendants.	)	CIVIL ACTION NO. 3 90 0581 Judge Nixon Mag. Haynes

AFFIDAVIT OF BERNARD L. WEBB

Bernard L. Webb, having been duly sworn according to law states as follows:

1. I am presently employed as an actuarial and reinsurance consultant. My office address is 4841 Mill Brook Drive, Dunwoody, Georgia 30338. I expect to serve as an expert witness for Plaintiff, Cherokee Insurance Company in the above styled matter.

2. For most of my career I have been

a teacher. I taught at Georgia State University from 1967 until 1989. Prior to that I taught some classes at Wisconsin State University from 1963 until 1964. I also taught C.P.C.U. preparation classes from 1956 until 1962 as well as the Georgia Chapter of C.P.C.U. from 1968 until 1987. And lastly, I taught for a short period at the Insurance Institute for Asia and the Pacific in 1982 on behalf of the United Nations.

3. Since 1968 I have been a member of the National C.P.C.U. Examination Panel. From 1961 until 1979, I was a member of the National C.P.C.U. Grading Panel, since 1966, I have been a member of the American Academy of Actuaries. Also, I was the Director of the Basic Insurance School for the National Association of Professional Insurance Agents in 1980, 1989 and 1982.

4. Since 1988, I have been a consultant to the multi-state Antitrust Task Force. In 1987 and 1988, I was a consultant

to the Florida Academic Task Force for the Review of the Insurance and Tort Liability Systems. In 1984, I was consultant to the United Nations Commission on Trade an Development and from 1977 until 1980, I was a consultant to the U.S. Department of Justice. Also, in 1968 and 1969, I was a consultant to the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary of the United States Senate. From 1964 until 1967 I was an Actuarial Specialist for the Hardware Mutual Casualty Company. From 1962 until 1964, I was Executive Secretary of the Insurance Advisory Committee of the City of Richmond, Virginia. From 1953 until 1955, I was the sales correspondent for the Hardware Mutual Casualty Company. Since 1985, I have been the Director of the Physicians' Insurance Company of Michigan.

5. I am a member of the American Academy of Actuaries; The American Risk and Insurance Association; the Casualty Actuarial

Society; the International Actuarial Association; the Society for Insurance Research; the Society of Chartered Property and Casualty Underwriters [Past President of the Georgia, Virginia and Northern Wisconsin Chapters; and Past Editor of C.P.C.U. Annals (now C.P.C.U. Journal]; and a member of the Southern Risk and Insurance Association.

6. I obtained a B.S. in Business administration from the University of Richmond in 1949 and a M.S. in Business Administration from the University of Richmond in 1964. I became a Fellow in the Casualty Actuarial Society in 1964 and obtained my C.P.C.U. designation in 1956.

7. I was the Robert E.Early Visiting Scholar at the American Institute for Property and Liability Underwriters in 1979 and 1980. I was named the Alumni Distinguished Professor for the College of Business Administration at Georgia State University in 1978. I also received the Ben

F. Hadley Award by the Griffity Foundation for Insurance in 1976. I have written many books and articles. (A list of which is attached hereto as Exhibit A)

8. It is my expert opinion that great differences exist between brokers and reinsurance brokers/intermediaries. Direct insurance brokers are primarily sales people, their expertise is in the area of policy coverage and analysis of insurable loss exposures. Few of them have sufficient knowledge of insurance company finance and accounting to access the solvency and solidity of an insurer. Reinsurance brokers/intermediaries, must by the nature of their business, have an understanding of insurance company finance and accounting. Reinsurance is an important element in an insurer's financial planning. A reinsurance broker/intermediary must understand the effects of reinsurance as on insurer's finances and accounting statements in order

to assist his clients in the design and execution of a reinsurance program. Consequently, the assessment of a reinsurer's solvency and solidity should not be beyond the abilities of a qualified reinsurance broker.

9. Another notable difference is that most direct insurance agencies and brokerage firms are small, and many are very small. One survey of direct agents showed that 93% of respondents wrote less than $7 million in premiums annually, with 72% writing less than $2.5 million. (what It Costs, 1990 Edition, Rough Notes Company, pp. 4-5). Most of this premium income must be forwarded on to the insurer - the agent or broker keeps only his commission, typically about 15% of the premium. At that rate, an agency with $7 million per year in premiums would have commission income of about $1.05 million per year.

10. In contract, E.W. Blanch Co. had

estimated gross revenues (Comparable to the commission figure cited above) of $47.2 million in 1989. Its premium volume in 1989 was $940 million. (Business Insurance, November 12, 1990, pp. 3, 10). It is apparent that Blanch has both the financial and personnel resources to make reasonable investigations of the financial strength of the reinsurers with which they placed reinsurance. A typical direct insurance agent or broker is lacking in both areas.

11. I will testify that blanch, being a reinsurance intermediary, had a duty to financially analyze and continual monitor the financial stability of the reinsurers with which it placed ceding company's, namely Cherokee's business.

12. My in-depth analysis of the annual financial statement of Mission Insurance Company ("Mission"), Transit Casualty Insurance Company ("Transit"), Universal Reinsurance Corporation ("Universal Re"),

Northwestern National Insurance and Mutual Fire Marine and Inland ("Mutual Fire"), reveals that at the time Blanch placed Cherokee's business with these reinsurers, Blanch knew or with the exercise of reasonable care, should have known that these companies were financially troubled and represented poor security.

13. If a reinsurer has over 75% of policyholder's surplus represented by Reinsurance Recoverables, the reinsurer may be financially troubled; therefore, the reinsurer's Schedule F (a portion of the Annual Financial Statement) should be reviewed to determine the quality of the retrocessionaires. Blanch did not test the relationship between reinsurance recoverables and policy holder's surplus for the reinsurers to which business was ceded. See Deposition of Leo Heifetz pp. 67, 225. Furthermore, blanch did not look to Schedule F. to see what retrocessionaires were

represented in a reinsurer's reinsurance recoverables. See Deposition of Leo Heifetz p. 70. Blanch was negligent no to conduct such an examination. If Blanch had conducted such an examination it would have known that the reinsurers at issue were financially troubled at the time of placement.

14. If a reinsurer has over 50% of policyholder's surplus represented by investments in subsidiaries, the actual value of the subsidiaries should be examined. Blanch did not test the relationship between the reinsurer's investment in their subsidiaries and their policyholder's surplus. See Deposition of Leo Heifetz p. 71. Blanch was negligent not to test this relationship. If the actual value of the investments in subsidiaries had been examined as regards Mission, Universal Re, and Northwestern National, Blanch would have known of their financial troubles at the time of placement.

15. Blanch failed to adequately investigate the reinsurers with which it was placing Cherokee's business and thereby breached its duty to provide Cherokee financially sound reinsurers.

_____
BERNARD L. WEBB

STATE OF TENNESSEE:
:
COUNTY OF DAVIDSON:

Sworn to and subscribed before me this _____ day of September, 1991.

_____
NOTARY PUBLIC

My Commission Expires: _____

October 29, 1980

SALES AND SERVICE BULLETIN

NUMBER 305

SUBJECT: Marketing Guide

The attached Marketing Guide is for internal use only. Do not show it to anyone who is not an E. W. Blanch Co. employee.

The Marketing Guide should be used as a supplement to rather than a replacement for the current Marketing Slips. It is not intended to control or limit your placement activities. By referring to the Guide, you should be able to identify markets who are known to be active in a particular area, and as situations change, the Marketing Guide will be revised accordingly. The fact that a particular market is not shown in a specific category does not mean that it will not write in that category. It simply means that we haven't been as successful in dealing with that market as we have with the ones listed.

You will note that there are no references to normal property reinsurances in the Guide. It is felt that the Specific Marketing Slip is all that is required where property business is concerned.

Please direct your comments or questions relative to the Marketing Guide to Carol Rennie.

E. W. BLANCH CO.

Marketing Guide

Excess Casualty Markets	Comments:
Allendale:	S. Moore has returned; will consider.
Alliance:	Will make special effort to be cooperative. Will play in working area.
Allstate:	Desires retro rating. Becoming somewhat arbitrary.
American Risk Mgmt.:	Express interest in this area. Moiser left October 17, 1980 so subject to change in underwriting.
Associated Treaty Mgrs.:	Cooperative market.
Barrett:	Writes mostly low layer Casualty. Personal visit recommended (not overly fond of E. W. Blanch, Co.)
Buffalo Re:	Should be considered, as we are trying to rebuild relationship. No National Re origin business.
Christiania:	Willing to write Casualty Quota Share, intermediate layers; will look at working excess.

Cologne Re:	Attempting to build book with E. W. Blanch Co. Prefer upper layers.
Commercial Union:	Is more aggressive. Nolen willing to entertain lower layers. Will occasionally quote.
Constellation:	Willing to set terms and lead.
Constitution:	Generally cooperative market when supported by Property.
Dominion:	Cooperative.
Duncanson & Holt:	Speak with Jack Stoke. Willing to entertain writing the PIP portion of Auto Liability as an A & H exposure.
Elkhorn:	Will follow good lead. Willing to write low layers.
Fireman's Fund:	Cooperative. Seems extremely hungry on working layers, but this may change due to new direction.
Gerling:	Will write, will do Workers' Comp; no Excess and Surplus lines.
Great American:	More willing to write non-working Casualty. Does write surplus lines business covers.

INA:	Requires claim and underwriting audit prior to quote. Won't write flat rated covers.
Kemper:	Wants to get terms and lead cover. Needs personal visit for best results. Friendly, but still not competitive.
MONY Re:	Poor grasp of Casualty business. Cutting back. Interested in wide swing retro.
National Casualty:	Will not write Casualty business.
National Union:	As of January 1, 1981, Chris Milton will have a $5,000,000 capacity over $1,000,000 and wants to lead; willing to use capacity.
Nationwide:	Will write large lines if they like it -- doesn't happen very often. More willing to write if property program offered also.
NERCO:	Should be considered on all Casualty covers. Contract Division will look at MGA business.
Northeastern:	Supporting market. Cooperative.
N.Y. Exchange:	Should not be ignored, especially for Umbrella; AIG and C&F Pools active Casualty markets.

Pacific Re:	Aggressive and cheap; good Umbrella market.
Prudential:	Will write big lines of Casualty Excess of Loss. Happy to work on excess limits premium basis.
RECO:	Wants to reinsure vanilla type book of business. Guyer says he will now look at some E&S.
Skandia:	Difficult to work with, but can write significant lines. Very helpful with enough information. Personal visit and they set terms for best results.
Tokio Re:	Forrest interested in low and intermediate Casualty.
Trenwick:	Specialty market. Indicates they are able to give St. Paul paper, but not now on Casualty Marketing List.
URC:	Lead and/or support market. Cooperative.
Winterthur:	New market; is writing Umbrella and "tough" classes.

Casualty Clash Covers Markets	Comments
AGF:	Vickery maintaining Phila. Re standards; wants to be excess of $1,000,00

AMLICO:	Bradbury expressed desire to see Casualty Clash.
American Union:	Will write $1,000,000 line if they set the price. Been very helpful.
Colonge Re:	Following market.
Employers of Wausau:	Is willing to write.
Ennia:	Will write when rating.
Gerling Global:	Want to set terms. Cooperative on renewals, but conservative on new business.
London:	Becoming more aggressive.
Metropolitan Re:	Interested in writing higher layer Casualty and would like to quote.
National Union Fire:	Willing to write, but may not include punitive.
Philadelphia Re:	Must be in excess of $1,000,000
Prudential:	Erratic, but can write large line if they set the price.
Tokio Re (NY):	Willing to write Clash.

Casualty - Umbrella Business Markets	Comments
Allendale:	Follower only

American Union:	Cooperative - generally lead.
Barrett Treaty:	Following; especially for inside excess covers to Quota Share.
Commercial Union:	Follower - Nolen is hungry.
Dorinco:	Following market.
Elkhorn:	Follower
Hannover:	Following market.
Insco:	Huge capacity; on LMX supplemental list.
Jauch & Hubener:	German market - can be helpful on Umbrella.
Kemper:	Says it will write; little evidence of that.
London:	Market can be helpful; suggest Clayton or Carter, Wilkes & Fane. Good prospective brokers on casualty.
MONY Re:	Says it will write.
National Union:	Currently following market; may wish to lead after January 1 ,1981.
NERCO:	Will write, particularly as part of general Casualty treaty.

NERFAC:	Facultative Department of New England Re. Will write Umbrella on Automatic or Semi-Automatic Fac basis.
Northeastern:	Following market.
NWNL:	Len Meredith is contact.
N.Y. Insurance Exchange:	AIG and C&F Syndicates will write.
Pacific Re:	Aggressive and cheap.
Prudential:	Will write; has large capacity.
RECO:	Doubtful.
RUC:	Will lead.
Skandia:	Will write in both Facultative and Treaty Departments.
Russell Re:	Can do more Casualty these days.
Universal:	Cooperative, but generally following market.
Tokio Re:	Forrest for underlying. Bingamen for high layer excess.
Winterthur:	Will write willingly.

NB: For "everyone in the work" who can be approached, see the K & K marketing list or talk with Biehl/Windhorst.

Excess Funded Covers Market	Comments
Alliance Re:	Will write tax (low risk) funded and probably funded Catastrophe with greater risk.
Christiania:	Will write tax (low risk) funded and probably funded Catastrophe with greater risk.
Colonge Re:	Interested.
Constellation:	Will write tax (low risk) funded and probably funded Catastrophe with greater risk. Sticky on amount of interest credit. Willing to quote and lead.
Constitution:	Will write tax (low risk) funded and probably funded Catastrophe with greater risk.
Dorinco:	Extremely cooperative. A following market.
Employers of Wausu:	Will write tax (low risk) funded and probably funded Catastrophe with greater risk.
Ennia:	Following market.
Fireman's Fund:	Very cooperative. Investment credit can be a problem. Good lead on smaller farm accounts.

General Security:	Will write tax (low risk) funded and probably funded Catastrophe with greater risk.
Gerling Global:	Cooperative.
Hannover Re:	Willing to write.
INA:	Have not written any, but say they want to. Requires personal visit.
Liberty National Fire:	Has written Catastrophe Excess Ratio.
Lloyds:	Probably can do something in this market. Suggest Clayton may be the best broker for this kind of business. Heath (Gren) also fees it could do something, probably without interest credit or on funds withheld basis.
Mead Re:	Willing to write, will consider on funds withheld basis.
NERCO:	Willing to consider anything. Leads. Probably will handle thorough Graham-Watson Division. Call Jim Duffy.
Northeastern:	Will write tax (low risk) funded and probably funded Catastrophe with greater risk.

PMA:	All kinds. New market and very enthusiastic. Generally an "easy" market.
Prudential:	Willing to consider anything. Leads. Prefers not to pay interest.
RECO:	Slightly changing attitude. Will consider plain vanilla but not Catastrophe layers.
Skandia:	Reluctant, but premium volume can overcome reluctance.
Unity Fire & General:	Will write tax (low risk) funded and probably funded Catastrophe with greater risk.
URC:	Cooperative. Willing to quote and lead.
Worexco:	Very cooperative.

Surplus Relief and Quota Share Market	Comments
Alabama Farm Bureau:	Preferred market.
Christiania/ Switzerland General:	Has expressed interest.
Colonge Re:	Has expressed interest.
Constitution:	Expensive.

Continental Casualty:	Has expressed interest.
Fireman's Fund:	Very cooperative, but depends on individual situation.
Highlands:	Interested but untested.
Liberty National Fire:	Margin requirements tend to be high.
MONY Re:	Very interested.
NERCO/First State:	Interested; perhaps best approached through Graham-Watson.
Ranger:	Won't write A & H. Could be a temporary situation. May not be a long term in this area.
Republic:	Preferred market.
RECO:	Noncompetitive.
Skandia:	Interested in seeing more. Needs all the details for his Management, Legal Department, etc.

Fidelity and Surety Market	Comments
Allstate:	Contacted Ted. Crumm.
INA:	
Kemper:	
Northeastern:	Following market.

Prudential:	
RECO:	Contact Paul Rossetti.
Skandia:	Contact Bill Adams.
Travelers:	
URC:	

Fronting Markets	Comments
American Security:	Client.
BSP Insurance Company:	We have special relationships here.
Central National:	Check with M. Cashman.
Central States of Omaha:	Willing to look at anything in Colorado or Nebraska.
Fireman's Fund:	
Guarantee (ATM):	
Guaranty National:	
Northbrook:	
Ranger:	
Southeastern Fire Ins. Co.:	Note: this is not our client - Southeastern Fidelity.

Western National:	Client. Check with P. McMorrow.

Mortgage Assumption Endorsements Markets	Comments
Allstate:	Will entertain, but are careful and conservative.
Christiania:	Conservative; will issue if a participant in working treaty and is held harmless by all reinsurers. Prefer endorsements to blanket letters.
Commercial Union:	Essentially a "no".
Constitution:	Will issue, agrees with E. W. Blanch co., Sales and Service Bulletin #407.
Elkhorn:	Not an issuing company, but indicated support for Hold Harmless.
Mission:	Is issuing, using Pacific Re, for Strudwick.
NERCO:	Will issue, requires Hold Harmless from reinsurers and sometimes from holding company parent of reinsured company. Requires numbered endorsements and feels broker has responsibility for making sure new reinsurers to program complete Hold Harmless

	Agreements to cut-through issuing carrier.
Unigrad:	During visit August 4, 1980 indicated a willingness to issue cut-throughs, but no response to our bulletin.
Universal:	Will issue; agrees in general with our procedures. Wants E. W. Blanch Co. to handle all details of tracking endorsements. Also feels issuance of cut-throughs is valuable marketing tools for them - that for such service they should be able to have pick of program and participation.
Winterthur:	Will issue. For Property lines require indemnification by reinsured as well as coreinsurers (particularly if reinsured is owned by a holding company; would then want access to parent company). For Casualty lines would need 100% indemnification. Will charge $10 per endorsement, no maximum fee.

101st Congress
Committee
2d Session
101-1

COMMITTEE PRINT

Print

FAILED PROMISES

Insurance Company Insolvencies

A REPORT

BY THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON ENERGY AND COMMERCE

U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 1990

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON 1990

has also had trouble getting some banks to pay on the letters of credit, which are supposed to be irrevocable and immediately available when a reinsurer fails to honor a valid claim. Thus, the amount of security was entirely inadequate, and availability has not worked smoothly.

There were three basis segments to Mission's business. The first was the traditional workers' compensation coverage that was largely centered in California and a few other western states. Next was commercial multiple peril, excess and surplus lines, and general liability coverages that were directly written by Sayre & Toso for Mission, and reinsured with different companies. The final segment was direct business written by other companies that was reinsured by Mission through Pacific Re, and largely reinsured again by passing most of the risk to outside members of Pacific Re's reinsurance pools.

All three segments contributed to Mission's brief spurt of expansion and its ultimate collapse. Although workers' compensation rates are set by state regulations, Mission was widely known for attracting more business through excessive premium rebates and cash incentives for its agents. Industry sources have told the Subcommittee that underpriced workers' compensation coverage meant inevitable trouble for the carrier.

Sayre & Toso aggressively wrote the large direct commercial liability policies that generated substantial commission income for Mission Insurance Group at the holding company level. The six percent commission earned by Sayre & Toso as an MGA was apparently intended to offset the extra risks associated with underpricing, since Mission

was retaining less than five percent of the business for its own portfolio. The rest was reinsured by Sayre & Toso with other companies that paid fees in the range of 15 to 25 percent for assuming business produced by this MGA.

As MGA for Mission and outside reinsurers, Pacific Re operated annual reinsurance pools where participants paid six percent of gross premiums for Pacific Re to find and manage reinsurance business on their behalf. These pools were basically joint ventures among the participating companies, with Mission sharing ten to twenty percent of the risks assumed. Again, Mission Insurance Group enjoyed the benefits of the fees collected by Pacific Re for writing large amounts of business, while Mission supposedly retained a minimum risk exposure.

The agency operations of both Sayre & Toso and Pacific Re were based on the premise that reinsurance of the substantial risks written in Mission's name would always be there to pay their full share of any losses. However, this premise was undetermined by the way the reinsurance programs were handled. IN addition to the complex arrangements and multitude of companies involved, the geographic dispersion and financial viability of many of the reinsurers selected by Sayre & Toso and Pacific Re virtually assured that eh system would break down.

Many of the approximately 600 reinsurers used by Sayre & Toso for Mission's direct business were United States companies not admitted to do business in California. About 75 percent of the reinsurers were foreign companies based in Germany, France, Italy, Japan, Belgium, the Netherlands, Finland, Norway, Denmark,

Greenland, Kuwait, Great Britain, Australia, Algeria, Egypt, India, Israel and many other countries. ON the Pacific Re assumed reinsurance side, there were 78 reinsurers of Mission and 56 of them were either not admitted to do business or were foreign companies.

There have been allegations that Mission intentionally sought reinsurers which were far away and unsophisticated because they would be more likely to believe what they were told without checking. For example, the Subcommittee was informed that in Europe it is considered impolite to audit reinsurance programs, as it implies a lack of trust in the business relationship. In view of the Subcommittee's findings, this curious attitude should be reexamined for the benefit of everyone involved.

Others have charged that the unlicensed reinsurers conspired to use Mission as a front to gain access to lucrative premiums in the United States marketplace. They say the reinsurers were knowledgeable professionals who have only themselves to blame for failing to meet their responsibilities. The result of such claims and counterclaims has been acrimonious and extensive litigations between the Mission receiver and the reinsurers who have not paid the gigantic losses from the business written by Sayre & Toso and Pacific Re.

Both Mission and its reinsurers had ample reasons to enjoy the party while it lasted. The reinsurers took hundreds of millions of dollars in premiums, while Mission puffed up its own financial image, and earnings. It is clear that Mission and its subsidiaries equally clear that many reinsurers may not have exercised prudence and sound judgment in their dealings with

Mission.

Now that the party is over, there is a bitter fight to determine who shall pay the ultimate costs of Mission's failure. As noted by the company's receive, the real issue is not merely the resolution of legal rights and duties as between the Mission companies and the reinsurers, but rather resolution of the broader obligations of both the Mission companies and the reinsurers to the insurance buying public.

RECKLESS MANAGEMENT

The story of Mission's failure is really a tale of reckless and incompetent management. This took various forms, including poor underwriting, severe underpricing, grossly inadequate reserving, accounting gimmicks, false reporting, and an overall disregard for the well-being of Mission and the constraints of the marketplace. The record developed by the Subcommittee displays an attitude among senior management of arrogance and indifference, accompanied by a readiness to blame everyone but themselves for the inevitable results of their actions and omissions.

At the helm was Mr. E. Richard De Rose as president and chief executive officer responsible for Mission Insurance Group and its subsidiaries. For almost 20 years, Mr. De Rosa firmly directed the activities of Mission with a style he described as "hands-on" management. The initial decision and full implementation of Mission's fatal plunge into reckless growth and excessive reinsurance occurred under Mr. De Rosa's leadership.

$60,000 to $70,000 per month, so Ranger's management decided to pay the MGA an additional $2 million just to settle the litigation.

This testimony confirms the Subcommittee's own view that using MGA's can be exceedingly dangerous. Although they may operate for all intents and purposes as insurance companies, the activities of MGA's are not really regulated. Uncontrolled MGA's have been a root problem in every major insolvency studied by the Subcommittee, and the presumption that all insurance companies will control their MGA's is clearly false.

TRANSIT CASUALTY: THE TITANIC OF INSOLVENCIES

Shortly after beginning its Mission investigation, the Subcommittee was told by industry sources that the failure of Transit Casualty Company would be even larger and more ominous in its implications for the insurance industry. The Subcommittee began to explore these charges, and quickly found a willing and cooperative ally in Transit's present state-appointed receiver for liquidation. The receiver, who has termed Transit the "Titanic of insurance company insolvencies," has been very active in seeking the causes and persons responsible for the failure, as well as attempting to coordinate an orderly liquidation.

The efforts of the Subcommittee and Transit's receiver have illuminated a situation that truly merits its description as the biggest and most outrageous insurance insolvency in history. The receiver's estimates of the cost to the public from Transit's failure have claimed progressively from $400 million to $2 billion to his latest

figure between $3 billion and $4 billion. He admits that no exact estimate of cost can be given at this time because of disarray and uncertainty in the company's book of business.

What is certain about Transit at this time is that its levels of management incompetence, excessive reinsurance, and reckless expansion through MGA's equal or exceed those observed at Mission and Integrity. The story of Transit's failure also includes the bailing out by its holding company when trouble appeared, and tales of sordid deceit and breathtaking underwriting by certain MGA's. Unlike the Titanic, the captain and the owners of Transit jumped ship before it went down, and left the results of their handiwork to be borne by regulators and the public.

The Subcommittee's investigation of Transit's failure included interviews and testimony from the receiver and his staff, as well as former officers and directors of Transit and its holding company. The independent audit firm was interviewed and its workpapers reviewed. Additionally, the activities of one MGA subagent, Carlos Miro, were carefully scrutinized through document requests, testimony, and interviews in the United States and Great Britain. Subcommittee hearings relating to these matters were held on March 13 and 29, and April 5, 11, and 19, 1989.

Prior to its demise, Transit operated from its headquarters in Los Angeles, California as a licensed insurance company in all fifty states and the District of Columbia. The company was chartered in Missouri in 1945, and its primary business originally was writing commercial property casualty coverages for motor transportation risks such as municipal buses, charter buses, and long-haul truck

SUPERIOR COURT OF CALIFORNIA

COUNTY OF LOS ANGELES

INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA, Appellant,	)	NO. C 572724
vs.	)	CERTIFICATE OF CLERK AND ORDER
MISSION INSURANCE COMPANY a California Corporation Respondent.	)	

I, FRANK S. ZOLIN County Clerk/Executive Officer of the Superior Court of the County and State aforesaid, do hereby certify:

That the Register of Actions in the above entitled action discloses that:

1. ORDER APPOINTING LIQUIDATOR AND RESTRAINING ORDER was filed February 24, 1987.

2. APPLICATION FOR ORDER OF LIQUIDATION AND MEMORANDUM OF POINTS AND AUTHORITIES was filed February 2, 1987.

that thereafter the documents were misplaced and a complete and diligent search of our records has failed to produce them.

WHEREFORE, it is prayed that he Court direct the Clerk file copies aforestated as originals for the purpose of reconstructing the case file to the extent possible.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the Seal of said Superior Court this 10th day of June, 1987.

FRANK S. ZOLIN, County Clerk/ Executive Officer of the Superior Court of California, County of Los Angeles.

By_____
Deputy

O R D E R

GOOD CAUSE APPEARING, it is hereby ordered that the Clerk file copies of said document filed in the above entitled action as the originals, as the original documents were lost. Said documents to be filed are listed on the preceding page(s) of this Certificate.

DATED:_____

_____

JOHN K. VAN DE KAMP, Attorney General
of the State of California
EDMOND B. MAMER,
REYMOND JUE,
Deputy Attorneys General
3580 Wilshire Boulevard
Los Angeles, California 90010
Telephone: (213) 736-2038

Attorneys for Applicant

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF LOS ANGELES

INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA,	)	
Appellant,	)	**NO. C 572724**
vs.	)	**ORDER APPOINTING**
MISSION INSURANCE COMPANY a California Corporation	)	**LIQUIDATOR AND RESTRAINING ORDER**
Respondent.)		

The verified Application for Order of Liquidation of Respondent; Mission Insurance Company came on regularly for hearing on February 24, 1987, in Department 86 at 9:00 a.m., the Honorable Ricardo Torres, judge presiding. Applicant appeared by his counsel John K. Van De Kamp, Attorney General of the

State of California, by Raymond Jue, Deputy Attorney General, there was no other appearance.

IT IS HEREBY ORDERED THAT:

1. The Insurance Commissioner of the State of California is appointed in his official capacity as Liquidator of Respondent, Mission Insurance Company as directed to liquidate and wind-up the affairs of Respondent in California and to act in all ways and exercise all powers necessary for the purpose of carrying out this order;

2. Title to all assets of Respondent now in the possession of the Insurance Commissioner as Conservator hereof, as well as title to any assets of said Respondent discovered hereafter is hereby vested in said liquidator;

3. Said Liquidator, as such, is hereby authorized to pay as expenses of administration, all expenses heretofore incurred by the conservator of Respondent and

presently unpaid and is hereby authorized to pay the full amount of any checks or drafts which have been issued by the conservator of Respondent and which are presently outstanding and unpaid, when said checks or drafts are presented for payment;

4. The rights and liabilities of creditors, policyholders, shareholders, and all other persons interested in the assets of Respondent, including the State of California, are fixed as of the date of entry of this order;

5. Respondent and its officers, directors, agents and employees and all other persons are hereby enjoined and restrained from transacting any of the business of Respondent in California or the disposition of any of its assets or property;

6. All persons are hereby enjoined and restrained from interfering with the possession, title and rights of Applicant as liquidator, in and to the assets of

Respondent, and from interference with the conduct of the liquidation in the winding up of the business of Respondent;

7. All persons are hereby enjoined from the waste of assets of Respondent;

8. All persons are hereby enjoined from instituting or prosecuting any action or proceedings against Respondent, or Applicant as Liquidator of Respondent, without the consent of this court obtained after reasonable notice to said Liquidator;

9. All persons are hereby enjoined from obtaining preferences, judgments, attachments or other liens, or making any levy against Respondent or its assets without the consent of this court obtained after reasonable notice to said Liquidator;

10. All officers, directors, agents and employees of Respondent are hereby ordered to deliver to said Liquidator all assets, books, records, equipment and other property of said Respondent;

11. All funds and bank accounts in the name of Respondent, or Applicant as Conservator, are hereby vested in said Liquidator and said funds shall be subject to withdrawal from said banks upon the order of said Liquidator only;

12. All insurance agents and brokers are hereby ordered to account to the Liquidator or Respondent for all funds of Respondent held by them in their fiduciary capacity, as specified in Sections 1733, 1734 and 1735 of the Insurance Code, or due to Respondent, and directed to forward sid funds to Applicant as Liquidator, and said funds are vested in Applicant as Liquidator; and

13. Said Liquidator is hereby authorized to initiate such equitable or legal actions or proceedings in this or other states are may appear to him necessary to carry out his function as Liquidator

DATED: February ___, 1987.

Ricardo Torres
Judge of the Superior Court

JOHN K. VAN DE KAMP, Attorney General
of the State of California
EDMOND B. MAMER,
REYMOND JUE,
Deputy Attorneys General
3580 Wilshire Boulevard
Los Angeles, California 90010
Telephone: (213) 736-2038

Attorneys for Applicant

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF LOS ANGELES

INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA,	)	
Appellant,	)	**NO. C 576324**
vs.	)	**ORDER APPOINTING**
MISSION INSURANCE COMPANY a California Corporation	)	**LIQUIDATOR AND RESTRAINING ORDER**
Respondent.)		

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presently unpaid and is hereby authorized to pay the full amount of any checks or drafts which have been issued by the conservator of Respondent and which are presently outstanding and unpaid, when said checks or drafts are presented for payment;

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DATED: February ___, 1987.

Ricardo Torres
Judge of the Superior Court

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of the State of California
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Deputy Attorneys General
3580 Wilshire Boulevard
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Telephone: (213) 736-2038

Attorneys for Applicant

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF LOS ANGELES

INSURANCE COMMISSIONER OF THE STATE OF CALIFORNIA,	)	
Appellant,	)	**NO. C 576416**
vs.	)	**ORDER APPOINTING**
MISSION INSURANCE COMPANY a California Corporation	)	**LIQUIDATOR AND RESTRAINING ORDER**
Respondent.	)	

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DATED: February ___, 1987.

Ricardo Torres
Judge of the Superior Court

TRANSIT

	1979	Percent
Policyholders Surplus	$ 25,540,867	100.00
Reinsurance Commissions	4,135,417	16.20
Subsidiaries		
(1) Investment	7,814,752	30.60
(2) Reinsurance Recoverables		
a. Paid Losses	675,337	2.60
b. Unpaid Losses	765,727	7.00
c. Unearned Prem.	3,808,572	14.90
d Total	5,249,636	20.60
Reinsurance Recoverables		
a. Paid Losses	97,674	.00
b. Unpaid Losses	13,822,418	54.10
c. Unearned Prem.	18,962,042	74.20
d Total	185,220,622	428.00
Agency Balances	10,147,268	39.70

TRANSIT

	1980	Percent
Policyholders Surplus	$ 43,116,819	100.00
Reinsurance Commissions	-4,327,647	-10.00
Subsidiaries		
(1) Investment	14,181,862	32.90
(2) Reinsurance Recoverables		
a. Paid Losses	36,306	.10
b. Unpaid Losses	497,430	1.20
c. Unearned Prem.	125,043	.30
d Total	658,779	1.50
Reinsurance Recoverables		
a. Paid Losses	1,622,244	3.80
b. Unpaid Losses	13,852,469	32.10
c. Unearned Prem.	3,555,780	8.20
d Total	19,030,493	44.10
Agency Balances	4,439,237	10.30

TRANSIT

	1981	Percent
Policyholders Surplus	$ 43,562,077	100.00
Reinsurance Commissions	13,681,314	31.40
Subsidiaries		
(1) Investment	13,901,873	31.90
(2) Reinsurance Recoverables		
a. Paid Losses	353,868	.00
b. Unpaid Losses	3,103,643	7.10
c. Unearned Prem.	352,175	.80
d Total	3,809,686	8.70
Reinsurance Recoverables		
a. Paid Losses	2,154,593	4.90
b. Unpaid Losses	20,425,514	46.90
c. Unearned Prem.	13,585,689	31.20
d Total	36,165,796	83.00
Agency Balances	8,708,193	20.00

TRANSIT

	1982	Percent
Policyholders Surplus	$ 43,863,195	100.00
Reinsurance Commissions	28,935,338	66.00
Subsidiaries		
(1) Investment	14,836,946	33.80
(2) Reinsurance Recoverables		
a. Paid Losses	457,447	1.00
b. Unpaid Losses	1,405,067	10.00
c. Unearned Prem.	226,636	.50
d Total	5,089,150	11.60
Reinsurance Recoverables		
a. Paid Losses	5,891,306	13.40
b. Unpaid Losses	49,723,158	113.40
c. Unearned Prem.	23,172,222	52.80
d Total	78,786,686	179.60
Agency Balances	20,683,036	47.20

TRANSIT

	1983	Percent
Policyholders Surplus	$ 43,699,831	100.00
Reinsurance Commissions	44,186,095	101.10
Subsidiaries		
(1) Investment	12,985,256	29.70
(2) Reinsurance Recoverables		
a. Paid Losses	555,231	1.30
b. Unpaid Losses	3,691,500	8.40
c. Unearned Prem.	908,693	2.10
d Total	5,155,424	11.80
Reinsurance Recoverables		
a. Paid Losses	9,546,311	21.80
b. Unpaid Losses	77,573,251	177.50
c. Unearned Prem.	46,147,81	105.40
d Total	133,267,543	305.00
Agency Balances	2,701,092	6.20

TRANSIT

	1984	Percent
Policyholders Surplus	$ 21,945862	100.00
Reinsurance Commissions	61,238,642	279.10
Subsidiaries		
(1) Investment	81,291,161	41.60
(2) Reinsurance Recoverables		
a. Paid Losses	919,062	3.70
b. Unpaid Losses	6,124,847	27.90
c. Unearned Prem.	1,372,300	6.30
d Total	8,316,209	37.90
Reinsurance Recoverables		
a. Paid Losses	22,778,972	103.80
b. Unpaid Losses	181,702,753	837.10
c. Unearned Prem.	51,170,655	233.20
d Total	257,652,383	1174.00
Agency Balances	3,063,163	14.00

MISSION

	1979	Percent
Policyholders Surplus	$112,119,439	100.00
Reinsurance Commissions	44,153,159	39.40
Subsidiaries		
(1) Investment	47,640,449	42.50
(2) Reinsurance Recoverables		
a. Paid Losses	5,508,222	4.90
b. Unpaid Losses	42,256,127	37.70
c. Unearned Prem.	14,687,121	13.10
d Total	62,451,470	55.70
Reinsurance Recoverables		
a. Paid Losses	9,186,664	8.20
b. Unpaid Losses	76,393,179	68.10
c. Unearned Prem.	45,107,654	40.20
d Total	100,687,497	116.60
Agency Balances	33,087,27	29.50

MISSION

	1980	Percent
Policyholders Surplus	$186,337,217	100.00
Reinsurance Commissions	57,824,141	35.60
Subsidiaries		
(1) Investment	85,972,758	52.90
(2) Reinsurance Recoverables		
a. Paid Losses	0.0	. 00
b. Unpaid Losses	56,387,316	34.70
c. Unearned Prem.	16,382,844	10.10
d Total	72,770,160	44.80
Reinsurance Recoverables		
a. Paid Losses	8,479,749	5.20
b. Unpaid Losses	100,652,151	62.10
c. Unearned Prem.	52,410,418	32.30
d Total	161,542,318	99.50
Agency Balances	27,837,274	17.10

MISSION

	1981	Percent
Policyholders Surplus	$186,337,217	100.00
Reinsurance Commissions	82,605,197	44.30
Subsidiaries		
(1) Investment	101,895,403	54.70
(2) Reinsurance Recoverables		
a. Paid Losses	95,639	. 10
b. Unpaid Losses	145,550,736	78.10
c. Unearned Prem.	39,113,907	21.00
d Total	184,760,282	99.20
Reinsurance Recoverables		
a. Paid Losses	14,994,041	8.00
b. Unpaid Losses	17,881,893	9.60
c. Unearned Prem.	45,965,793	24.70
d Total	78,841,727	42.30
Agency Balances	33,886,392	18.20

MISSION

	1982	Percent
Policyholders Surplus	$219,481,900	100.00
Reinsurance Commissions	61,543,056	28.00
Subsidiaries		
(1) Investment	124,192,101	56.60
(2) Reinsurance Recoverables		
a. Paid Losses	0.0	. 00
b. Unpaid Losses	183,900,678	83.80
c. Unearned Prem.	43,090,623	19.60
d Total	226,991,301	103.40
Reinsurance Recoverables		
a. Paid Losses	20,776,292	9.40
b. Unpaid Losses	136,220,983	9.60
c. Unearned Prem.	20,055,236	9.10
d Total	177,002,511	80.60
Agency Balances	12,176,177	5.50

MISSION

	1983	Percent
Policyholders Surplus	$233,333,613	100.00
Reinsurance Commissions	65,366,459	28.00
Subsidiaries		
(1) Investment	141,673,391	60.70
(2) Reinsurance Recoverables		
a. Paid Losses	0.0	. 00
b. Unpaid Losses	250,527,276	102.40
c. Unearned Prem.	47,123,477	20.20
d Total	97,650,753	127.60
Reinsurance Recoverables		
a. Paid Losses	27,961,874	12.00
b. Unpaid Losses	171,370,535	73.40
c. Unearned Prem.	19,454,494	8.30
d Total	218,786,903	93.80
Agency Balances	8,844,585	3.80

MISSION

	1984	Percent
Policyholders Surplus	$ 43,247,481	100.00
Reinsurance Commissions	43,247,491	100.00
Subsidiaries		
(1) Investment	61,267,754	141.70
(2) Reinsurance Recoverables		
a. Paid Losses	0.0	. 00
b. Unpaid Losses	138,223,769	319.60
c. Unearned Prem.	47,490,067	109.80
d Total	372,365,912	861.60
Reinsurance Recoverables		
a. Paid Losses	38,608,143	89.30
b. Unpaid Losses	138,223,769	319.60
c. Unearned Prem.	185,220,622	19.40
d Total	185,220,622	428.00
Agency Balances	14,915,254	34.50

MUTUAL FIRE MARINE & INLAND

	1979	Percent
Policyholders Surplus	$26,127,198	100
Reinsurance Commissions	19,559,166	74.90
Subsidiaries		
(1) Investment	5,909,445	22.60
(2) Reinsurance Recoverables		
a. Paid Losses	.00	.00
b. Unpaid Losses	.00	.00
c. Unearned Prem.	.00	.00
d Total	.00	.00
Reinsurance Recoverables		
a. Paid Losses	3,940,079	15.10
b. Unpaid Losses	63,352,824	242.50
c. Unearned Prem.	22,596,536	86.50
d Total	89,889,439	344.00
Agency Balances	5,770,517	22.10

MUTUAL FIRE MARINE & INLAND

	1980	Percent
Policyholders Surplus	$36,334,673	100
Reinsurance Commissions	18,440,219	50.80
Subsidiaries		
(1) Investment	6,328,304	17.40
(2) Reinsurance Recoverables		
a. Paid Losses	.00	.00
b. Unpaid Losses	.00	.00
c. Unearned Prem.	.00	.00
d Total	.00	.00
Reinsurance Recoverables		
a. Paid Losses	2,857,845	7.90
b. Unpaid Losses	77,050,443	212.10
c. Unearned Prem.	20,692,060	56.90
d Total	100,600,348	276.90
Agency Balances	8,150,314	22.40

MUTUAL FIRE MARINE & INLAND

	1981	Percent
Policyholders Surplus	$39,017,180	100
Reinsurance Commissions	16,039,380	41.10
Subsidiaries		
(1) Investment	9,998,733	25.60
(2) Reinsurance Recoverables		
a. Paid Losses	$-1732	.00
b. Unpaid Losses	2632	.00
c. Unearned Prem.	726	.00
d Total	1626	.00
Reinsurance Recoverables		
a. Paid Losses	6,242,988	16.00
b. Unpaid Losses	86,315,147	221.20
c. Unearned Prem.	15,902,192	40.80
d Total	108,460,327	278.00
Agency Balances	7,889,357	20.20

MUTUAL FIRE MARINE & INLAND

	1982	Percent
Policyholders Surplus	$18,850,183	100
Reinsurance Commissions	15,828,455	40.70
Subsidiaries		
(1) Investment	13,465,904	34.70
(2) Reinsurance Recoverables		
a. Paid Losses	.00	.00
b. Unpaid Losses	.00	.00
c. Unearned Prem.	.00	.00
d Total	.00	.00
Reinsurance Recoverables		
a. Paid Losses	17,328,815	44.60
b. Unpaid Losses	88,953,562	229.00
c. Unearned Prem.	18,010,384	46.40
d Total	124,292,761	319.90
Agency Balances	11,145,957	28.70

MUTUAL FIRE MARINE & INLAND

	1983	Percent
Policyholders Surplus	$37,179,491	100
Reinsurance Commissions	23,456,929	63.10
Subsidiaries		
(1) Investment	14,374,970	38.70
(2) Reinsurance Recoverables		
a. Paid Losses	29,767	.10
b. Unpaid Losses	239,360	.60
c. Unearned Prem.	482,946	1.30
d Total	752,019	2.00
Reinsurance Recoverables		
a. Paid Losses	8,999,629	24.20
b. Unpaid Losses	112,565,166	302.80
c. Unearned Prem.	22,888,123	61.60
d Total	144,452,918	388.50
Agency Balances	0.0	.00

MUTUAL FIRE MARINE & INLAND

	1984	Percent
Policyholders Surplus	$33,467,845	100
Reinsurance Commissions	32,590,655	97.40
Subsidiaries		
(1) Investment	7,928,972	23.70
(2) Reinsurance Recoverables		
a. Paid Losses	73,515	.20
b. Unpaid Losses	773,536	2.30
c. Unearned Prem.	4,549,245	13.60
d Total	5,396,296	16.10
Reinsurance Recoverables		
a. Paid Losses	15,628,492	46.70
b. Unpaid Losses	123,219,461	368.20
c. Unearned Prem.	31,143,787	93.10
d Total	169,991,740	507.90
Agency Balances	0.0	.00

IN THE CIRCUIT COURT OF
COLE COUNTY , MISSOURI

MARY C. HALL, Acting Director Division of Insurance Department of Economic Development State of Missouri Plaintiff, v. TRANSIT CASUALTY COMPANY 130 South Bemiston, Suite 101 St. Louis, Missouri 63105 Defendant.	)	Cause CV185- 1206CC Div.II

AMENDED ORDER OF LIQUIDATION AND
APPOINTMENT OF PERMANENT RECEIVER

Now on this 3rd day of December, 1985 the Petition for Liquidation filed by Mary C. Hall, Acting Director of the Division of Insurance, Department of Economic Development, State of Missouri, coming on for hearing an the defendant company by its president and member of the board of directors, Gerald Steven DeGennaro having entered a general appearance in behalf of defendant corporation, it is hereby ORDERED,

ADJUDGED AND DECREED that:

1. Transit Casualty Company is hereby declared to be insolvent;

2. Mary C. Hall, Acting Director of the Division of Insurance, Department of Economic Development, State of Missouri, is appointed permanent receiver with all powers and duties attendant thereof until further order of the Court;

3. John C. Cozad is hereby appointed Special Deputy Receiver;

4. The receiver is ordered to take possession of, with authority to transfer and control, the property, business books, records, and accounts of the company, and possession and control of the premises occupied by defendant for the transaction of its business;

5. The officers, directors, agents, employees of defendant Transit Casualty Company are and continue to be permanently enjoined and restrained from selling,

assigning or disposing of the business or of any of the assets of said Transit Casualty Company;

6. All of the creditors and claimants of defendant Transit Casualty Company, wherever situated, be and are hereby restrained and enjoined from levying any execution, garnishment or attachment on the property and assets of said Transit Casualty Company;

7. All persons, wherever situated are permanently enjoined and restrained from prosecuting or bringing any action, issuing any process or obtaining any judgment against defendant Transit Casualty Company or its properties or assets;

8. All persons, wherever situation are hereby enjoined from interference with the possession, title or rights of petitioner as Receiver in Liquidation in and to the assets of defendant Transit Casualty Company and from interference with the conduct of

liquidation of defendant Transit Casualty Company except as may be ordered by the Court;

9. All policies of insurance issued by defendant Transit Casualty Company cancelled effective at midnight on December 20, 1985;

10. The receiver is authorized to hire, retain, terminate employees as needed to effectuate the winding up and liquidation of the defendant company and to negotiate the terms of such employment relations;

11. The receiver is authorized to contract with independent contractors, including but not limited to attorneys, to perform services as needed to effectuate the winding up and liquidation of the defendant company;

12. The receiver is authorized to transfer, invest, re-invest and otherwise deal in the assets and property, real or personal, of the company so as to effectuate

the winding up and liquidation of the defendant company;

PERSONAL VISIT REPORT
(Outside Visits)

_____ Client
Prospect _____

_____ Market
_____

COMPANY UMI Group

PLACE Philadelphia, Pennsylvania

Date 1/11/83

PERSON(S) Ron Aller, Jack Matlack

Fac. Discussed? Life re Opport.? Blanch Personnel

___ Yes-Property ___ Yes Wilkinson
___ Yes-Casualty _X_ No _____
_X_ No _____

I was in philadelphia in regard to Reliance. Ron Aller had asked that I come by and visit him so that we could discuss what each of our firms is doing in the Bermuda Market. during our visit we covered the following:

1. Aller had been working, since joining UMI, in trying to diversify the Company. He has opened a life insurance company which is geared towards cable TV viewers, has a Bermuda operation, and has plans for a public offering to form a reinsurance company with 20 million dollars of capitalization in which he indicated 51% would be owned by UMI. The remaining 49% by outside investors.

Aller is a fairly aggressive and outspoken individual. He openly expressed some frustration in getting management to move on some of his diversification plans. I think he has a good working relationship with Matlack, but I think that he feels that Jack is in a "hold" posture since he is only five years away from retirement. As respects his Bermuda operation, there was really nothing that we could do together, however, he did want Wattiez to be able to meet his man in Bermuda, David Ezekiel.

2. I did have a brief visit with Matlack also. I discussed our investment rating plan which Aller was very interested in and Jack had some interest but was questioning some of the aspects. I think this definitely deserves a follow up visit in which we can present a sample model for their review. I will talk to Woll and maybe the two of us can arrange a lunch in Philadelphia.

Conclusion:

An unexpected good visit. We may have the opportunity to increase our position with this Company. aller did mention that 1982 is going to look very bad; Shad Monshan's experience apparently has deteriorated dramatically. There is some concern, on my part, about the financial viability of this Company if it has to weather very severe financial storms. This is something we need to continually watch.

Wilkinson

cc: Mile Wook - EWB, New York

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company	)	
Plaintiff,	)	
vs.	)	Civil Action
E. W. Blanch Co., E.W. Blanch JR., General Partner, Michael W. Cashman, SR., General Partner, FRANK S. WILKINSON, General Partner, and PAUL S. MAVROS, General partner,	)	No. 3-90-0581
	)	Judge Echols
Defendants.	)	Magistrate Haynes

MEMORANDUM OF LAW IN RESPONSE TO DEFENDANTS' MOTION FOR RECONSIDERATION AND IN SUPPORT OF PLAINTIFF'S MOTION FOR RECONSIDERATION

I. INTRODUCTION

Plaintiff, Cherokee Insurance Company by and through David S. Weed, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company ("Cherokee") respectfully submits this Memorandum of Law in Response to

A-2

Defendants' Motionfor Reconsideration and in Support of its Motion for Reconsideration. In the Court's Report and Recommendation of February 4, 1992, the Court found that evidence existed that Blanch knew or should have known of unreasonable financial problems with respect to Universal Reinsurance Corporation ("Universal Re") and Mission Insurance Company ("Mission"). The Court however found that no such evidence existed with respect to Mutual Fire Marine and Inland "(Mutual Fire"). Northwestern National Insurance Company ("Northwestern"), and Transit Casualty Company ("Transit"). Since February 4, 1992, evidence has surfaced which has forced Cherokee to drop its claims against Blanch regarding its placement of Cherokee's business with Universal Re and Northwestern[1]. However, Cherokee requests the Court to reconsider its ruling regarding Cherokee's claims against Blanch for Blanch's

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[1] Since February 4, 1990, Cherokee has decided not to employ Earl Lanning as an expert witness; therefore, all references to the testimony of Mr. Lanning in Defendants' Memorandum of Law in Support of Motion for Reconsideration are no longer relevant. Also, in its repsonses to interrogatories, cherokee had proposed Joseph L. Petrelli and James Clarke of Demotech as potential expert witnesses. Cherokee never has submitted any filings to the court regarding the opinions of Mr. Petrelli or Mr. Clarke nor does it intend to do so. since blanch has not proposed Mr. Petrelli and/or Mr. Clarke to serve as their expert witnesses, any and all references to testimony by either Mr. Petrelli or Mr. Clarke in DEfendants' Memorandum of Law in Support of Motion for Reconsideration are irrelevant.

placement of Cherokee's business with Mission, Mutual Fire and Transit.

II. ARGUMENT

A. A MATERIAL FACTUAL DISPUTE EXISTS AS TO THE SECURITY ANALYSES PRUDENT REINSURANCE BROKERS/INTERMEDIARIES WERE USING DURING THE 1980 TO 1984 TIME PERIOD.

(i) Blanch failed to perform security analyses being Advocated by other prudent reinsurance brokers/intermediaries and general industry sources during the 1980 to 1984 time period.

Guy Carpenter & Company, Inc., a reinsurance intermediary comparable to E.W. Blanch, and a major competitor of E.W. Blanch, disseminated into the public realm on January 1, 1983, what it perceived to be the prudent standard of care in the industry applicable to itself and its fellow reinsurance intermediaries. (Exhibit 1) Guy Carpenter stresses the importance of the reinsurance intermediary's initial review of reinsurers as well as the continuing review of all reinsurers stating:

> . . . As reinsurance intermediaries, we are not, of course, in a position to guarantee the security of any reinsurer, however, we do fully recognize our responsibilities to assist our clients by using good judgment in carefully reviewing each of the reinsurance markets with which we place business to be certain as possible that they meet our client's requirements. When we become aware of conditions which might jeapardize the ability of a reinsurer to respond to a loss, we take immediate action to ascertain the seriousness of the conditions' including direct discussions with the reinsurer when necessary and advise our clients as promptly as possible. . .

The foregoing assuraances clearly negate any contention of Blanch that a reinsurance intermediary is exercising due care if it places reinsurance with a reinsurer based upon the sole criteria that the reinsurer (1) is solvent at the time of placement, (2) is licensed by independent authorities; and (3) possesses a favorable A.M. Best Co. rating.

The document itemizes the analytical factors Guy Carpenter perceived to be important in any security review of a

reinsurance market:

1. The size of the company in terms of policyholders' surplus or equivalent net worth.

2. The volume of gross and net premiums written in relation to net resources.

3. The amount of loss, loss adjustment, expense and unearned premium reserves in relation to net resources and in relation to net premiums.

4. Underwriting performance and trends.

5. Mix of business.

6. Loss reserve development trends.

7. Investment portfolio with respect to liquidity, diversification and maturity.

8. Investment income in relation to gross premiums.

9. Analysis of cash flow from operations.

10. Loss Paying Margin - ability of the company to absorb an unusual shock.

11. Particular attention is devoted to trend analysis of underwriting and investment accounts over the current five years.

> 12. The management's record and reputation in the industry, and the extent of the company's commitment to the reinsurance business.

Blanch, like Guy Carpenter recognized its duty to its clients, namely Cherokee, as a reinsurance broker to conduct financial analyses and to be aware of the reputation of the reinsurance markets being utilized.

Cherokee's expert, Bernard Webb's testimony condurs with the security analyses propounded by Guy Carpenter and the ideas and views expressed in the trade press during the early 1980's. In his deposition of June 25, 1992 (Exhibit 2, "Webb" depo.), he stated regarding the role of the reinsurance intermediary and the necessity of security analyses:

> . . .Their function is to advise an insurance company on its reinsurance requirements and to do what they have to do to understand the effect of reinsurance on the financial operations of the insurance company and, therefore, if they have performed their function properly, they of necessity, have to understand the financial operations of insurance companies much

more so than a typical direct agent or borker. p. 19

. . .I think that the reinsurance broker has an obligation to analyze the condition of the companies in which he places business for his ceding companies barring of course, some contractual statement ot the contrary. pp. 97-98

Mr. Webb, when asked what specific analyses should be conducted, states many of the same factors set forth inthe document discussed by Guy Carpenter. See Webb Depo. p. 8. (Exhibit 2) Mr. Webb, concluded in his testimony that if Blanch had adequately performed its duty to financially analyze and continually monitor Mission, Mutual Fire and Transit during the 1980 to 1984 time period, it would have determined the financial weakness of the companies with which it was placing Cherokee's reinsurance. See Webb depo. p. 6. (Exhibit 2).

Undoubtedly, the early 1980's were a period of unrest in the reinsurance business and intermediaries such as Blanch and Guy Carpenter were well aware of the changing

environment. See "Why the World Reinsurance Market Has the Jitters," Institutional Investor, 175, January, 1980. (Exhibit 3) The role of the reinsurance intermediary was undoubtedly feeling the effects of this changing environment. On the front page of "The National Underwriter," on December 5, 1980, appeared an article entitled"Re Brokers: Stronger Role." (Exhibit 4) This article addresses the changing conditions in the reinsurance industry at the time and describes the role and duties of the reinsurance intermediary as a result thereof:

> **In the United States the reinsurance intermediary enjoys a strong and growing position inthe development of treaty reinsurance. The broker has drawn together in an orderly fashion reinsurance markets of adequate financial strength to create needed arrangements. It has been his role to create or fulfill capacity needs in the development of new and existing lines of insurance, and in many cases, this reinsurance capability has allowed pioneers to have grewat success in new insurance products.**
>
> **Another role of significant importance is that of monitoring the**

> financial integrity of new an existing markets. The broker must analyze financial statements of reinsurers to make certainthat they are capable of insuring the kind of loss expenses which potentially can develop, particularly in catastrophic events. .
>
> In a word, the broker's role in a market such as we see today is, as never before, one that may be best described as responsible. The proper cultivation of the market falls squarely onthe shoulders of the professional reinsurance intermediary. He must meet this challenge with an enlightened and studied attitude for it may well be that the success or failure of the remarkable emerging reinsurance market potential inthe United States will depend onthe manner in which the broker performs his role as the catalyst in creating and maintaining capacity. pp. 14-15

What Blanch urges was being done by it and other reinsurance intermediaries during the 1980 to 1984 time period as far as analysis of markets being used, undeniably conflicts with the expert testimony and other proof Cherokee has submitted regarding what was and shold have been being done during this time. Furthermore, what Blanch urges was being done by it and other intermediaries

during the 1980 to 1984 time period conflicts with the representations and assurances being made by Blanch to cherokee, specifically, and to the public, generally. The brochures and other advertisements being disseminated by Blanch described its role as "all encompassing." Blanch is in hindsight attempting to minimize the great responsiblity it was, in actuality, assuming during the 1980 to 1984 time period especially in the case of its relationship with Cherokee. Mr. Webb places much importance upon how the intermediary represents itself to the client. In his deposition, he states:

Q. So it is your testimony that it is the custom within the reinsurance brokerage community to accept delegation of the function of analyzing reinsurance companies on behalf of the ceding company so that the ceding company doesn't have to do it itself, is that right?

A. It is my testimony, if a reinsurance broker holds himself out as being qualified to advise his ceding company clients with regard to the

placement of insurance that he has, in fact, accepted the responsibility for analyzing the reinsurance.

pp. 43-44.

Cherokee argues that Blanch held itself out as advisor to it, the cedant, on the subject of Cherokee's reinsurance program and that blanch was neglient in failing to adequately analyze the financial condition of the reinsurers participating. At a minimum, Cherokee insists that the views and beliefs of Guy Carpenter, Bernard Webb and the available trade press on the subject of the security analyses to be performed by the prudent reinsurance intermediary create a material factual dispute.

(ii) Even if Blanch was exercising the same degree of care as other reinsurance borkers, Blanch was nevertheless negligent.

In its Report and Recommendation, the Court held that "Blanch was only bound to exercise the degree of ordinary care applicable to tother reinsurance brokers."

(Report and Recommendation, p. 4) Cherokee urges the Court to consider that even if the Court continues to conclude that Cherokee has failed to offer sufficient proof of the particular financial analyses being performed by reinsurance brtokers exercising ordinary care during the 1980 to 1984 time period, Cherokee has nevertheless offered sufficient proof of what should have been done by Blanch and other brokers to constitute reasonable purdence. Material factual issues remain as to whether the whole sector of reinsurance intermediaries during the 1980 to 1984 time period were in fact acting negligently.

If the standard of care among reinsurance intermediaries prevalent when Blanch obtained the reinsurance at issue for Cherokee was negligent, and Blanch abided by such standard, Blanch was negligent. In Tennessee, negligence is the failure to use due care and reasonable care under the circumstances. See Street v. National

Broadcasting Company, 512 F.Supp. 398, 407 (E.D. TN. 1977); Duckworth v. Greyhound LInes, Inc., 469 F.2d 424, 426 (6th Cir. 1975). Although what constitutes due or reasonable care under the circumstances may be evidenced by what is customarily and ordinarily done, such is not, by any means conclusive. the Restatement Second of Torts §295A states:

> In determining whether conduct is negligent, the customs of the community or others under like circumstances are factors to be taken into account but are not controlling where a reasonable man would not follow them.

Similarly, The Tennessee Courts have consistently upheld the view tht "what usually is done may be evidence of what ought to be done, but what ought to be done is fixed by a standard of reasonable prudence, whether it usually is complied with or not." Easterly v. Advance Stroes Co., 432 F. Supp. 7, 9 (E.D. TN. 1976); and Baker v. Pidgeon Thomas Company, 422 F. 2d 744 (6th Cir. 1970)

["Contractors are held both to custom and industry standards and to a standard which would be followed by a reasonably prudent man and must adhere to whichever of the standards is more exacting if he is not to be held negligent."]

Wherefore the law is clear the customary practice in a given industry or trade is generally relevant yet not dispositive, to prove what is the exercise of ordinary care under a given set of circumstances. The Comment of § 295A of the Restatment Second Torts recognizes that some customs and usages "are the result of careful thought and decision." However, the Comment emphasizes that "others arise fromthe kind of inadvertence, neglect or deliberate disregard of known risk which is associated with negligence." The Comment concludes:

> No group of individuals and no industry or trade can be permited by adopting careless and slip shop methods to save time, effort or money, to set its own uncontrolled standard at the expense of

> the rest of the community. It follows therefore that whenever the particular circumstances, the risk or other elements in the case are such that a reasonable man would not conform to the custom, the actor may be found negligent in conforming to it; and whenever a reasonable man would depart from the custom, the actor may be found not to be hegligent in so departing.
>
> p. 62

Indicative of the foregoing general legal principals are two Nedw Jersey Superior Court cases Erlich v. First National Bank of Princeton, 505 A 2d 220 (N.J. Super. 1984) and Mazur v. Selected Risks Ins. Co., 558 A 2d 508 (N.J. Super A.D. 1989). The Erlich case involved an investor seeking damages for the mismanagement of his Custodian Management Account (CMA) by the defendant Bank. The complaint alleged negligence, malpractice, breach of fiduciary duty and breach of contract. The agreement entered into by the plaintiff investor and the defendant bank provided for a nondiscretionary account with the Bank periodically examining securities

held in the CMA and recommending sales and purchases that in the Bank's opinion were in plaintiff's best interest. The agreement further provided that no transactioncould be executed without plaintiff's written authorization. In addition, the agreement exculpated the Bank from Liability resulting either from its good faith recommendations or its failure to make recommendations.

At the outset, the Court noted that "Industry custom and practice are commonly looked to for illuminationof the appropriate standard of care in a gegligence case", but the Court did not denote industry custom and practice to be dispositive. Id, p. 234. The Court arrived at what it considered the appropriate standard of care under the circumstances stating that the defendant Bank, as an investment manager, was obligated to give prudent advice which was held to encompass:

(1) knowing the customer, his assets and objectives;

(2) diversifying investments;

(3) engaging in objective analysis as the basis for purchase and sale recommendations; and

(4) making the account productive.

p.235

In holding that the defendant Bank had mismanaged the Plaintiff's account and in striking the exculpatory clause as unconscionable, the Court emphasized that "the Hallmark of a professional is the ability to exercise sound judgment in advising clients." Id, p. 237. The Court further rationalized:

> The plaintiff in the case at bar sought the expertise of a professional investment advisor because he was dissatisfied with his own ability to manage hsi investments. He was entitled to rely on defendants to give prudent advice to achieve his investment objectives. When it appeared that his account was suffering losses as a result of their advice, he was also intitled to expect that defendant's further advice . . . would restore profit to the account. Id, p.

Ultimately, the Court's determination that the defendant Bank was negligent was founded not merely onwhat appeared to customary practice inthe industry but also upon what the Court sensed was reasonably purdent behavior under the circumstances.

In the Mazur case, the plaintiff, an insured, instituted suit against his insurance broker alleging the broker's failure to give him appropriate advice and appropriate insurance coverage. The Court allowed an expert to testify as to what a prudent insurance broker would have done under similar circumstances. Although the Court looked to the expert testimony as relevant to the standard of care and concurred with such testimony in finding the defendant broker to have been negligent, the Court, consistent withErlich, did not rely solely on the testimony but instead, it

determined, in light of such testimony, what it believed to be reasonable practice under the circumstances.

In summary, the law is clear that the standard of care in a given profession under specific circumstances is dictated, first, by deference to what is generally accepted custom and practice in the industry; and secondly, by Court designation of such industry custom and practice as the product of careful thought and decisionnot the product of mere inadvertence, neglect or deliberate disregard of known risks.

If the custom and practice in the industry in the 1980-1984 era was for reinsruance intermediaries to look merely to the minimum requisites that the reinsurers (1) were solvent at the time of placement; (2) were licensed by independent authorities; and (3) possessed a favorable rating; then the industry standard was negligent. Wherefore, Blanch was negligent even if as it

urges, it was doing what was expected of reinsurance intermediaries at the time.

B. A MATERIAL FACTUAL DISPUTE EXISTS AS TO WHETHER BLANCH WAS NEGLIGENT IN PLACING CHEROKEE'S BUSINESS WITH MISSION DURING THE 1980 TO 1984 TIME PERIOD.

The Report and Recommendation correctly determined that a material factual dispute exists regarding whether Blanch negligently placed 25% of Cherokee's main working treaty with Mission in 1984. Blanch alleges that the Court reached the foregoing conclusion based solely upon "Docket Entry No. 43, Exhibit B", an inernal memorandum of Blanch, which appeared to delet Misision fro the "Approved marketing List" in 1983. Cherokee disagrees with Blanch's allegation and contends that the Court did not rely on this document exclusively, but relied on other evidence as well to reach its conclusion. Furthermore, Cherokee contends that additional evidence exists whichcreates a

material factual dispute, not only regarding Blanch's placement of Cherokeee's business with Mission in 1984, but Blanch's placements with Mission in 1982 and 1983.

The Court refers to "Docket Entry No. 43, Exhibit 8 thereto, Subcommittee on Oversight & Investigation of Committee on Energy and Commerce, 101st Cong. 2d Sess., Report on Insurance Insolvencies II (Comm. Pring 1990) (hereinafter referred to as the Dingell Report). The Court notes that Mission became the target of Congressional investigation after "sources in the insurance industry predicted that Mission would be the 'largest insolvency in history.'" (Report and Recommendation p. 17) The Court then goes on to reiterate the Dingell Report's finding that Mission had a "solid reputation' and high Best's rating until it began an excessive reliance on reinsurance around 1980." (Report and Recommendation p. 17)

Cherokee contends as it has throughout

the course of this litigationthat Blanch knew or should have known through the exercise of reasonable diligence of facts and circumstances which would put it on notice that Missionfailed to represent strong security when Blanch placed Cherokee's business with Mission in 1982, 1983 and 1984. The Dingell Report as it pertains to Mission clearly supports the position of Cherokee. The Court quoted the Dingell Report's ultimate conclusions on the failure of Mission:

> The story of Mission's failure is really a tale of reckless and incompetent management. This took various forms including poor underwriting, severe underpricing, grossly inadequate reserving, accounting gimmicks, false reporting and an overall disregard for the well being of Mission and the constraints of the marketplace.

The documents maintained by Blanch as early as 1980 and reviewed by Blanch's Market Security committee reveal knowledge by Blanch of the Dingell Report's subsequent

conclusions. In a "Sales and Services Bulletin" disseminated within Blanch dated October 29, 1980, the "marketing guide" defined Pacific Re (an underwriting manager at Mission - See Joint Motion, Stipulation and Order of February 18, 1992) as "aggressive and cheap." (Exhibit 5)

In its defense, Blanch urges that Cherokee's expert witness, Mr. Webb, even testified that Mission appeared to be financially viable company in the early 1980's and even recommended Mission to a client in the early 1980's. (our emphasis). When Mr. Webb made these comments, he was referring to the very early 1980's - "1980, '81." Webb depo. pp. 30-31. (Exhibit 2) The comments were the result of questioning regarding a 1980 or 1981 recommendation made by him to his client, the Carolinas' Roofers Association, to use Mission over the only alternative, Mead Re. Mr. Webb explained the recommendation as follows:

> You have to understand the circumstances with regard to Mission. The choice was between Mission and Mead Re. The roofers are not considered higly desirable insureds and the only quotations that they were able to obtain were from Mission and Mead Re. At the time shaky, besides which Missionwas a licensed company in South Carolina and Mead Re wasn't which meant that they should have had the protection of the guaranty association with regard to Mission. So I said if you have this choice, I would go with Mission, if this is the only choice you have.
>
> Webb dep., p. 30 (Exhibit 12).

Blanch placed Cherokee's business with Mission in 1982, 1983 and 1984. Mr. Webb's comments in no way exculpate Blanch. Cherokee is not alleging that Blanch negligently chose to place its business with Mission in 1980 or 1981. Furthermore, unlike Mr. Webb's situation where he had only one other reinsurer from which to choose for his client, blanch could have chosen from a multitude of other reinsurers to assume 25% of Cherokee's Main Working Treaty.

In the 1980 to 1984 time period, Blanch

recognized tht Mission was not historically involved in the reinsurance business. Mission originated as a workers' compensation carrier and relied heavily on its workers' compensation business. See "Workers' Compensation Help Mission Insurance Stay Ahead," 50, Business Insurance, April 20, 1981. (Exhibit 6) Blanch nevertheless placed 25% of Cherokee's main working treaty with Mission in 1982, 1983 and 1984. A factual issue clearly exists regarding whether blanch was negligent in 1982 and 1983, but especially in 1984. By 1984, the future of Mission was highly questionable. See "Will Mission be Sold After Derosa leaves?" Business Insurance, October 31, 1983. (Exhibit 7).

Regardless of any correction of the record involving "Docket Entry No. 43, Exhibit B," sufficient proof exists to support the Court's conclusions that factual issues remain with respect to Blanch's

negligence in the placement of Cherokee's business with Mission in 1984. Cherokee urges that suffiecient proof also exists to support a finding that factual issues remain with respect to the 1982 and 1983 placements with Mission.

C. A MATERIAL FACTUAL DISPUTE EXISTS AS TO WHETHER BLANCH WAS NEGLIGENT IN PLACING CHEROKEE'S BUSINESS WITH MUTUAL FIRE AND TRANSIT DURING THE 1980 TO 1984 TIME PERIOD.

(i) Blanch was negligent in placing Cherokee's business with Mutual Fire during the 1980 to 1984 time period.

In its Report and Recommendation, the Court refers to a January 11, 1983, Personal Visit Report written by a Blanch employee, Wilkinson, following a meeting with the UMI Group, which in essence is Mutual Fire. (Report and Recommendation, p. 13). The court quotes the portion of the Report where Wilkinson voices "some concerns . . .about the financial viability of this company if it has to weather very severe financial storms.

This is something we need to continually watch." cherokee argues that the conclusions f this personal visit Report create a material factual dispute as to whether Blanch was negligent in placing 100% of Cherokee's financial guaranty insurance program with Mutual Fire in 1983 and 1984. Blanch contends that Mutual Fire was the sole reinsurance company willing to reinsure Cherokee's financial guaranty insurance progra. If Blanch's contentions are true, Cherokee was never made aware. And nevertheless, any inhibitions Blanch had about the financial stability of Mutual Fire should have been conveyed to Cherokee whether or not Mutual Fire was the sole reinsurer willing to reinsure cherokee's financial guaranty insurance program.

Another document indicative of Blanch's concerns is a Personal Visit Report dated January 4, 1983. Ther Report concluded:

> "Ned (Vice President of Mutual Fire) has big plans for the future and would like EWB Co's help. the only thing that we must be careful of, is that Ned's plans aren't too big, too fast. . ." (Exhibit 8).

Blanch clearly had concerns about the financial strength and capacity of Mutual Fire. Not ony did blanch recognize the financial woes of Mutual Fire, Blanch also recognized Mutual Fire's inexperience as a reinsurer. In a Personal Visit Report, dated January 27, 1983, a Blanch employee Graham wrote regarding his visit with Mutual Fire: "A very pleasant meeting, I would like to do more business with these people; They seemed to want to become professional reinsurers." (our emphasis) (Exhibit 9).

Blanch knew Mutual Fire was a newcomer to the reinsurance business and was growing entirely too rapidly. Obviously, blanch shose to give business to Mutual Fire despite their reservations about their expertise or financial stability as a reinsurer.

Unfortunately, Cherokee was a victim of blanch's negligence. Cherokee respectfully requests the Court to find that a material factual dispute remains as to whether Blanch was negligent in placing Cherokee's business with Mutual Fire during the 1980 to 1984 time period.

(ii) Blanch was negligent in placing Cherokee's business with Transit during the 1980 to 1984 time period.

The court, in its Report and Recommendation quotes the Dingell Reports' findings that:

> The Subcommittee observed active broker participation in some of the worst deals taken by Mission and Transit, yet the brokers involved denied responsibility for either the consequences of those deals, or for inquiring into the real identities and financial condition of the parties involved. Respectable borkers have said their duty of inquiry extends only to checking company solvency ratings published by the A.M.Best service. However, they admit such ratings are not dependable solvency guides because they are based essentially on unverified information published by insurance companies themselves. (Report and Recommendation, P. 19)

The problems the Dingell Report found to have lead to Transit's demise, namely, "management incompetence, excessive very apparent to Blanch by 1983. The Dingell report's conslusions are easily understood when the history of Transit as a reinsurer and the financial information available onTransit during the 1980 to 1984 time period are examined. Transit incorporated as a reinsurance business until 1978. See A.M. Best Reports 1982, 1983 and 1984 on Transit attached as Exhibit 10. As in the case of Mutual Fire, Blanch seems to have chosen to ignore, to cherokees detriment, the naivite of Transit in the reinsurance business. Transit's 1982 financial statement shoed Transit had 179.60% of its policy holder's surplus composed of reinsurance recoverables. (Exhibit 11). If over 75% of policyholder's surplus is represented by reinsurance recoverables, there is need for concern. See Affidavit of Bernard L. Webb (Exhibit 12).

The Dingell report, the experience of Transit as a reinsurer and the financial information available on Transit during 1983 and 1984, create a material factual dispute as to whether Blanch knew or should have known of the financial instability of Transit, and, was therefore negligent in placing 50% of Cherokee's Commercial Umbrella Treaty with Transit 1983 and 1984.

CONCLUSIONS

For the reasons stated above, Cherokee's claims agains Blanch for placement of Cherokee's business with Mission, Mutual Fire and Transit during the 1980 to 1984 time period should not be dismissed; and, Blanch's Motion for Summary Judgment should be denied.

Respectfully submitted

Weed, Hubbard, Berry & Doughty

By: _____
William B. Hubbard (2770)

Brenner B. Lackey (13302)
424 Church St., Ste. 2006
Nashville, TN 37219
(615) 255-1773

CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing Memorandum has been forwarded by first-class mail, postage prepaid to: Mr. Daniel P. O. Keefe and John Orenstein, Dorsey & Whitney, 2200 First Bank Place East, Minneapolis, Minnesota, 55402; and Mr. Jay Bowen, First American Center, Nashville, Tennessee, 37238, on this the _____ day of September, 1992.

_____
William B. Hubbard (2770)

x 32.

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company, Plaintiff,	)	
vs.	)	Civil No. 3-90-0581
E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, and FRANK S. WILKINSON, General Partner, and PAUL S. MAVROS, General Partner, Defendants.	)	

DEPOSITION OF

BERNARD L. WEBB

June 26, 1992

10:15 a.m.

28th Floor
2 Peachtree Street
Atlanta, Georgia

Renda K. Cornick, CCR-B-1107
BROWN REPORTING, INC.
1100 Spring Street - Suite 750
Atlanta, Georgia 30309
(404) 876-8979

professional background?

A. Yes.

Q. Exhibit 1 states that generally you will testify that Blanch as a reinsurance intermediary involved in a relationship like the relationship that existed between Blanch and Cherokee had a duty to financially analyze and continually monitor the financial stability of the reinsurers, and you will further testify that had Blanch properly performed that duty, it would have determined that the reinsurers at issue in this case were financially impaired or were operating in such a manner that they were likely to become financially impaired before Cherokee's losses were due.

Does that accurately summarize the assignment that you were given and the opinion that you will be rendering in this case?

A. Yes, it does.

Q. Have you been given any other

assignments by Cherokee Insurance Company other than as set forth in these interrogatory answers?

A. No, none that I can think of anyway.

Q. Have you been given any assignments by Cherokee different from those set forth in the interrogatory since the interrogatory was executed

insurance companies. What factual basis do you have to support that view?

A. I think perhaps I said they should be, I am not sure whether it may have come out that they are, but they should be. Their function is to advise an insurance company on its reinsurance requirements and to do that they have to understand the effect of reinsurance on the financial operations of the insurance company and, therefore, if they have performed their functions properly, they, of necessity, have to understand the

financial operations of insurance companies, much more so than a typical direct agent or broker.

Q. So it would be your view that if one has the expertise to understand the impact that reinsurance can have on the financial condition of a company, that of necessity would also arm them with the expertise to analyze and detail all aspects of the financial condition of an insurance company; is that right?

A. With one possible exception, and that is they might not necessarily be equipped to make detailed analysis of a company's investment

with respect to South Carolina Roofers Association?

A. From the late '70's to about 1984 of '5.

Q. What companies did you advise them about?

A. Insurance Company of North America was one of them, Mission was one of them, Mead Reinsurance was one of them.

Q. Any others?

A. I am sure there were, but I don't recall. It has been several years.

Q. What was your advice with respect to INA?

A. That I considered them sound.

Q. How about Mission?

A. You have to understand the circumstances with regard to Mission. The choice was between Mission and Mead Re. The roofers are not considered highly desirable insureds and the only quotations that they were able to obtain were from Mission and Mead Re. At the time Mead RE looked very shaky, Mission looked less shaky, besides which Mission was a licensed company in South Carolina and Mead Re wasn't which meant that they should have had the protection of the guaranty association with regard to Mission. So I said if you have this choice, I would go

with Mission, if this is the only choice you have.

Q. Did you advise them that Mission looked shaky?

A. No, I didn't.

Q. When was this, by the way? You gave me a time period late '70's to 1984, when exactly within that time period?

A. Would have been very early '80's, '81, probably. Another one that I did advise them on was Ideal Mutual.

Q. What did you say on Ideal?

A. That I didn't like them but, again, the alternative was Mead Re and, again, I thought Ideal looked better than Mead Re.

Q. But you didn't tell them that for Mission, did you?

A. No, I didn't.

Q. Mission in the early 1980's looked on paper to be a viable insurance company,

did it not?

A. That's correct. The fact that I thought they would have the protection of the guaranty fund if Mission went under was a major factor which I did point out to them in my letter.

Q. But you weren't predicting Mission was going to go under?

A. No. But I did suggest being a licensed

Q. You did?

A. Yes.

Q. You weren't a broker, though?

A. No. I am not a broker and I don't know that the broker did.

Q. You were hired separately and paid a fee to perform that function, isn't that true?

A. That is correct.

Q. Who hired you to do that?

A. The fund, the Carolinas self-

insured roofers self-insurance fund.

Q. Do you know why they didn't do that themselves?

A. Didn't know how.

Q. Do you know why the didn't simply rely on their broker to do it?

A. I did a number of other things for them. That is not the only thing I did. It is just simply one of the things I did along the way. I don't know why they didn't rely on their broker, I never asked them.

Q. In your view, is it one of the responsibilities of management of an insurance company that purchases reinsurance, that is a ceding company to analyze the financial strength of its

reinsurers?

A. I think it is their duty to have it done one way or another. If they consider that they don't have anyone on staff who is adequate to perform that function, then I

think they have an obligation to delegate it to somebody else, a broker or consultant or whatever.

Q. What if they do have someone on staff with that expertise?

A. If they had someone on staff that they considered had that expertise, I would assume that they would use that person even though they might also ask other people to do the same thing.

Q. Now, you indicated that management either ought to have that analysis done in-house or delegate it to somebody to do. How does management go about delegating that sort of function if it is not going to be done in-house?

A. They could rely on their reinsurance broker to do it or they could hire an independent consultant to do that.

Q. Is it customary within the reinsurance field for a reinsurance broker to accept delegation of that function?

A. Most reinsurance brokers hold

themselves

out as being qualified to advise their ceding company clients regarding the placement of their reinsurance. I think that to the extent they do that, they are assuming the responsibility.

Q. Is it customary for reinsurance brokers to accept delegation of the responsibility to analyze the financial strength of reinsurance companies on behalf of the ceding company?

A. If the reinsurance broker holds himself out as being qualified to advise his ceding company clients with regard to the placement of their reinsurance, then I think he is, in fact, accepting delegation of that responsibility.

Q. So it is your testimony that it is the custom within the reinsurance brokerage community to accept delegation of the function of analyzing reinsurance companies

on behalf of the ceding company so that the ceding company doesn't have to do it itself; is that right?

A. It is my testimony if a reinsurance broker holds himself out as being qualified to advise his ceding company clients with regard to the placement of the insurance that he has, in fact, accepted the responsibility for analyzing the reinsurance.

Q. Let's start over. You are not answering the question that I am asking and you know full well you are not answering the question I am asking.

MR. HUBBARD: I don't think that is true, I think he is answering the question you are asking.

Q. (By Mr. O'Keefe) Let's start over. Is it your testimony, sir, that it is the custom and practice within the reinsurance brokerage community for reinsurance brokers to accept delegation of

the function of analyzing the financial strength of reinsurance companies on behalf of ceding companies thereby relieving the ceding companies of the custom and practice within the reinsurance brokerage field?

A. I would have to give you the same answer, it is the only way to answer that question, it is not a yes or no answer. There is no way to give a yes or no answer to that question.

The responsibility that the reinsurance broker accepts depends upon what he holds himself out as being able to do when he solicits business from a ceded company.

Q. Do you consider it to be responsible

behavior on behalf of the ceding company to assume that a reinsurance broker is going to perform the function of determining whether the financial strength of a reinsurance company is adequate without management

confirming with the broker that the broker will perform that function?

A. I think that would depend on what you mean by confirming with the broker.

Q. Having some sort of discussion, having it verbalized in some fashion, be it in writing or otherwise.

A. I think that the company should have some reason to believe that the broker anticipates doing that, but I think if a broker comes in and says, you know, I am a professional reinsurance man, or woman, and I want to advise you upon what kind of reinsurance you buy and where you buy it, that he has stated that he is going to do that.

Q. And management doesn't have to do it itself, then; is that right? Is that your testimony?

A. Well, I think management would be well advised to do it themselves, but I think they could also be well advised to rely on an outside person if they think that outside

person has greater expertise

that. That is the reason they are in annual statements.

Q. What is your explanation, then, for the regulator, A.M. Best Company and the CPAs who audited these companies and other industry professionals did not pick up on the financial problems of these insurance companies?

A. Other than regulators and people who were dealing directly with these companies, there is no reason that insurance professionals or auditors should look at them. There are over 3,000 property and liability insurance companies in the United States. I don't know of anybody, even A. M. Best Company, who analyzes all of them. Most people analyze only those that they think are going to affect them in some way.

Q. And it is your position, I gather, that even though A. M. Best Company, other

rating services, regulators, auditors who audited these companies, and the rest of the industry didn't pick up on these red flags that reinsurance brokers, even ones who did business with hundreds of reinsurance companies, they themselves should have picked up on it; is that right?

A. I think that the reinsurance broker has

an obligation to analyze the condition of the companies in which he places business for his ceding companies, barring, of course, some contractual statement to the contrary.

Q. What should they do in analyzing it?

A. Essentially the same things I did. They might want to go further on some of the companies, depending on what they find in those areas. But the IRIS test and the other tests I ran should be a reasonable indication, plus in doing an analysis of on

ongoing company, I would probably do an analysis of the loss reserve development to the extent it is possible from a series of annual statements.

Q. So you would look at the IRIS test and loss reserve development and --

A. And the other ratios I ran that we discussed earlier.

Q. What other ratios?

A. The ratio of ceding commissions to policyholders surplus, a ratio of investment in subsidiaries and affiliates to policyholders surplus, a ratio of reinsurance recoverables from affiliates to policyholders surplus, and a ratio of reinsurance recoverables from nonaffiliates to policyholders surplus.

Why the world reinsurance market has the jitters

The reinsurance business has changed, and too much business is being written at too low rates by too many players. The day of reckoning may not be far off.

by Lynn Brenner

"Reinsurers always remind me of the little guy in the cartoon." an insurance commissioner once remarked. "You know the one I mean: He's running at top speed, runs straight off a cliff, but he keeps spinning his legs in mid-air until he realizes there's nothing under him and he plummets like a stone."

Reinsurance is, of course, the insurance that insurance companies buy. It's a largely unregulated, more than $30 billion international business, growing at a rate of about 15 per cent a year, and it is thuddingly cyclical: As its practitioners so often put it, "We can't stand prosperity."

Indeed, when underwriting results are good, everyone lowers rates to get more business and cash in on the good times. Soon premiums get too low to produce an underwriting profit, and industry leaders thunder evangelically about "irresponsible competition and dangerously low rates" --- all the while hanging onto market share for dear life, which naturally entails cutting rates still more. Finally a catastrophic loss turns the market around: Hurricane Betsy in 1965 cost $715 million, for instance, and in her wake many reinsurers picked up what few marbles they had left and went home; the survivors raised their rates to respectable levels again and breathed a

sigh of relief.

Today, reinsurers are again running for dear life in mid-air. Everyone says rates are disastrously low, but no one wants to be the first to raise them. Nor, of course, will any reinsurer admit to writing business at inadequate rates himself. "Everyone tells you he's reducing volume because he won't cut rates, right?" asks a leading broker. "Well, I haven't seen any signs of it. If they're not writing at these rates, what are they all complaining about?" One reinsurer tells of a group of Mongolians who traveled to a reinsurers' conference last year seeking new coverage on their cattle. They had lost half their herd the year before, but they argued they should have a lower rate than before because the cattle that survived were the fittest. "Did they get it? In today's market? Sure," he says.

Disconcerting differences

"The reinsurance market today is appalling," affirms one insurance analyst. "It stinks." Furthermore, he and others in the industry find disconcerting differences between this market and its pre-Betsy predecessor that suggest a potentially greater wrench when the market is finally cleansed and rights itself again. They cite the following:

* **More players.** A staggering number of companies have leaped into international reinsurance in the past fifteen years (see box, page 180). The market is scattered all over the globe and, especially compared to earlier days, is splintered and chaotic. The new, inexperienced companies have taken on risks at rates that many label irresponsible, and the sheer number of players, both new and old, suggest that this down cycle will last longer than previous ones.

* **Inflated claims.** Reserving for losses is the key to reinsurance, but deciding what future claims will cost in an atmosphere of double-digit inflation is little more than a guessing game. Also, it is pointed out, casualty losses are vulnerable to social as well as economic inflation, and reinsurers sell far more casualty coverage --- which pays for legal liabilities like medical malpractice --- than they did fifteen years ago. As has been startlingly demonstrated in the past few years, changing interpretations of tort law and hefty jury awards can vastly inflate a casualty claim. "Who the hell knows what it'll cost twenty years from not to pay the guy who slipped on IBM's floor?" asks one underwriter. "And pharmaceutical products liability --- DES is a drug that was discontinued in the 1950's, and the claims are coming in now."

* **More exposure.** Catastrophe exposure has grown in real as well as inflationary value. "In 1938, when a hurricane blew straight up the East Coast of the U.S.," says David Thompson, president of North American Reinsurance Co., Swiss Re's U.S. subsidiary, "Long Island was just truck farms. Can you imagine what it would cost today?"

* **Higher potential losses.** As a result of real and inflationary growth, reinsurers' liability is much higher than it was in 1965. "Back then, you placed less than $150 million of catastrophe reinsurance for ten insurers," says one broker. "Today, one insurer has that much." In 1979, British and American insurers bought 47 million and $289 million more of catastrophe reinsurance, respectively, than in the year before and, because of the slide in 1978. "Twenty-five per cent more exposure, but no more money. We shall be offering green stamps next," comments Andrew Drysdale, a Lloyd's of London

underwriter.

* **Fluctuating currencies.** Before Hurricane Betsy, reinsurance was largely parochial. As it has become international, reinsurers have had to deal with currency fluctuations, and though the giants reserve in the currency in which they'll pay the claim, some industry leaders think the exchange-rate roller coaster will be enough to precipitate the next big shakeout. " A splendid example of international reinsurance incompetence" is what Drysdale calls the settlement of the Ford fire loss. The Ford plant in Cologne burned to the ground in late 1977 at an estimated property loss of Dm 348 million, hitting reinsurers all over the world. Claims weren't settled for a full year, during which time the dollar fell 25 per cent against the Deutsche mark. "No effort was made to buy the currency forward, even though the loss was known and generally quantifiable," says Drysdale. Ford's business interruption loss, estimated at Dm 425 million, has yet to be settled in November 1979, lengthening the currency exposure time of some reinsurers.

* **Greater complexity.** The nature of the reinsurance business itself has altered markedly. The primary insurer today can sell an enormous volume of coverage at low premiums and reinsure as much of it as he wants. If he reinsures all of it, he can make a risk-free profit on the commission he gets for producing and servicing the business. The more competition among reinsurers, the higher the ceding commissions they pay. In his turn, the reinsurer lays off some of the risk, buying his own reinsurance or retrocession, from fellow reinsurers. Today, risks are reinsured and retroceded so many times over, say reinsurers, that it's impossible to trace the ultimate recipient of the premium. "It can

bounce 40, 50 times." says one expert "Fire losses in the Bronx could bankrupt the People's Insurance Co. of China."

Big risks, small premiums

Every time a reinsurance premium bounces, it gets smaller, as ceding commissions and brokerage (reinsurance intermediaries are involved in retrocession as well as reinsurance) and sometimes management fees as well are taken out of it. Incoretically the risk gets smaller, too, but, in fact, the unwary reinsurer can wind up with almost all of the risk and almost some of the premium. "I think most reinsurers are afraid someone will succeed in tracing the premium, and the reinsurers will find out what bad shape they're in," says a primary broker cheerfully.

Moreover, retrocessional and reciprocal agreements between reinsurers are so complex that the reinsurer can easily accumulate pieces of the same risk again and again. The accumulation problem is so severe in earthquake reinsurance that reinsurers are now talking about asking for a federal back-up program. Almost every kind of reinsurance is vulnerable to earthquake loss, says James Koehnan, president of American Reinsurance Co. "It doesn't even need to be earthquake coverage. Fire coverage is part of every property policy. You could get earthquake loss through workers' compensation coverage: What if Lockheed is hit at 10 a.m. by an earthquake? And life, accident and health coverage can pick up earthquake losses, too." It's been estimated that if the 1906 earthquake hit San Francisco tomorrow, insured property losses alone would reach $50 billion.

To compound the problem, the reinsurer, as a wholesaler, is often ignorant of the

specific risks he's covering. In pro rata treaties, he's covering the primary insurer's judgment by accepting a share of its book of business. Two years ago, a pool of South American reinsurers were appalled to find that their London underwriting agent had bound them to a treaty in which they picked up 97 1/2 per cent of each auto liability loss sustained by an American insurer who had written a hug e volume of substandard risks at bargain-basement premiums. the insurer collected a ceding commission, the underwriting agent collected an overriding commission , and the South Americans suffered and underwriting loss that soared to $8 million in one year.

"It takes a management of the highest integrity not to be seduced into writing doubtful business, the results of which will take many years to emerge and will not affect its pocket when they do," Julius Neave, managing director of Mercantile & General Reinsurance Ltd. in London, remarked last year." Many unsuspecting insurers from overseas have been attracted into the London market by the easy accessibility offered to worldwide reinsurance. Many have burnt their fingers to the bone."

But so many people want to sell reinsurance today, says American Re's Koehnan, that an underwriter can bankrupt two pools, "cross the street and get a new lineup of companies tomorrow." Nor is retrocession an automatic safeguard, because the risk that reinsurers lay off can come back like a boomerang in the retrocession they accept. As one reinsurer recently put it, 'In business, you've got to know who you're dealing with."

The big pay-off?

Given the hazards of today's market ---

"The downside risk is enormous," says one analyst --- why would so many want to get into reinsurance? Because, of course, the potential profits are also enormous. "One guy on a phone can produce $100 million in premiums," says one expert. The time lag between premium payment and claim ---known in the industry as the "long tail" --- can be up to twenty years on lines like medical malpractice and product liability. That's a long time for a claim to grow with social and economic inflation, but it's also a long time for a reinsurer to milk the float.

In fact, the reinsurer provides one of the biggest to get into the reinsurance business siren song to newcomers is always the investment income," says North American Re's Thompson. "People always think they can underwrite at a loss and more than make it up on investments," agrees Edmond Rondepierre, general counsel of General Reinsurance Co. "They think, I'll get twice as much to invest if I have a combined ratio of 105 [paying $1.05 in losses and expenses for every premium dollar taken in] as if I write at 99." But reinsurers are unanimous in warning that this approach doesn't work: "Shoot for 99 and you get 101," says Rondepierre. "Shoot for 105 and you get 120, because when word gets out that you take substandard risks, that's all you'll be offered."

"Every newcomer thinks he can do what General Re does," says another reinsurer. In fact, Connecticut-based General Reinsurance Co. is the most frequently cited example of how to make money with reinsurance. Fifty-nine years old, the company is likely soon to be the only major independent direct reinsurer in the U.S.; American Reinsurance was bought by Aetna Life & Casualty last year, and Employer's Reinsurance currently is fending off a tender offer from Connecticut

General. while it is true that companies can make money at reinsurance despite underwriting losses -- if they're low enough, that is -- General Re is almost unique in that it consistently underwrites at a profit. For the first nine months of 1979 it reported a combined ratio of 98.94 per cent. Its net investment income after taxes was $85.8 million, or $7.88 per share -- a 27.5 per cent increase over the first nine months of 1978.

In the past ten years, General Re has increased its writing of facultative reinsurance -- coverage of big individual risks -- to more than half its book. Once sold almost exclusively in London, facultative reinsurance give the reinsurer much more underwriting and pricing control than treaty business. But unlike treaty, in which reinsurer and insurer traditionally have a long-term relationship, facultative is a one-shot deal. "It's Russian roulette," says one expert. "You need two things to write it: a helluva lot of savvy and a helluva pile of money. You make it big when you're right, but when you're wrong, you'd better have the money to pay and survive. If not, you're playing I Bet My Company, and many people today are doing just that."

Rate reductions in facultative casualty lines today are appalling, says Robin Jackson, lead casualty underwriter for the Merrett Dixey syndicate at Lloyd's. Nowhere has this been more evident that in aviation insurance, where rates actually went down after the estimated $150 million loss of the Tenerife crash. The fact that there are fewer crashes is sometimes cited as a defense for low premiums. But the severity of each loss has soared. The world's total gross aviation premiums -- about $500 million -- could be wiped out in a single loss, says one reinsurer. "You figure a 747's hull is

insured for $40 million. Then there's the crew and 350 passengers: a few years ago we were figuring $100,000 a life, but I don't know what it would be today. then there;s the baggage and cargo. Say two of them collide. Over Shea Stadium." Primary aviation underwriters actually boast that they pass 100 per cent of their risk to reinsurers, London underwriter Drysdale recently remarked.

Who's to blame?

As might be expected, the old timers in the reinsurance business blame inexperienced newcomers for the current rate-cutting. With the influx of new reinsurers, they argue, there just aren't enough experienced underwrites to go around. "It's the sincere idiots who are ruining the business," says Merrett Dixey's Jackson. "People don't own up to it, but I've seen books with ratios of 125. People are hired in positions they're not qualified for. There's irresponsible underwriting or no underwriting going on. Sanity has departed from the reinsurance business."

Veterans cite the woes of Bellefonte Financial Corp. as a classic example of newcomer innocence. An Armco subsidiary that grew from a pure captive to an insurer in ten years, Bellefonte had neither loss data nor experienced underwriters. It took a large volume of third-party liability coverage from other inexperienced underwriters and gave several general agents the authority to bind it to risks. One of them allegedly pocketed premiums, and Bellefonte, in addition to sustaining before-tax underwriting losses of $27.5 million in 1978, is bogged down in a lawsuit against the agent. It is also undergoing a full overhauling by its parent.

"You see ads in the trade press," says

one expert sourly, "'Casualty facultative underwriter wanted, two years plus commercial experience.' That's not experience. You've just pushed paper somewhere. These new underwriters get 25 to 30 per cent more than their primary counterparts, and what happens? After they lose business to a lower rate a few times, they start selling it for the price they lost it to." Another underwriter says newcomers are cavalier because "they've never been through a Betsy. They have no idea of the aggregate liabilities."

But hiring an old underwriter can cost a reinsurer more than his hefty salary. "There's a real syndrome of I'm 62 years old, I'll be retired or long gone when the chickens come home to roost, so who cares?' says and intermediary. The beauty of casualty reinsurance, says a reinsurer is that you can show your stockholders millions of dollars in no time, and the losses won't come in for years.

Oldtimers who have always dealt directly with clients also blame brokers for encouraging price-cutting -- and brokers share of the international reinsurance market has grown from 33 per cent before Betsy to 54 per cent today. "The broker makes money every time you change reinsurers." says one direct reinsurer, and another adds that the proliferation of brokers is a measure of the sorry level of sophistication of the market: "The guy who knows what he's doing doesn't need a broker. Broker share of the market has grown with the market itself, explains American Re's Koehnan: "The new entrants all assume from brokers, because doing it direct, as we do, is the most expensive way." But he is quick to add that many reinsurers who deal with brokers are thoroughly professional.

Brokers, of course, deny charges of encouraging low rates. "We like 'em low but not this low," says one intermediary. In

point of fact, the broker has several reasons to worry about low rates. In London, he often advances claims payments to clients, and were reinsurance or retrocession not to come through he could be in trouble. And though no broker likes losing a commission, the intermediary who steer an insurer away from a reinsurer is alienating a potential client, because reinsurer buy reinsurance, too. One leading intermediary, in fact, says he's lost business by advising clients against taking too low a rate.

As might be expected, the free-for-all has spilled into brokerage, too and leading intermediaries aren't any happier about it than their company counterparts. "You can hang out a sign saying Reinsurance Intermediary tomorrow, with no experience, and get business coming in," says one of them. "Anybody can find a market today." He would probably agree with the comment of robert Sloan, executive director of Commercial Union, who says there are "a lot of irresponsible brokers -- stupid, greedy, criminal or all three -- placing business on behalf of amateurs today."

But some observers insist that to say brokers are pushing down rates is placing the blame in the wrong place. "The underwriter has the pen," say Richard Gilmore, president of Mercantile & General Reinsurance Co. of America. A major intermediary adds flatly, " The marketplace sets the rates Obviously, enough people think rates are adequate to be writing. Every good broker vets the market for security, but in no sense can he guarantee it. The final decision to buy is always the client's."

Wherever the blame lies, "every line is in trouble," says one observer. After all, everyone is cutting rates on short-tail property business because it is rationalized as "safe" and on long-tail casualty business

because it gives reinsurers so much more time to hold the premium. And as everyone assumes more and more risk for less money, the conviction grows that many of today;s players are under reserved. "Many people today are insolvent and don't know it yet because the event hasn't happened to make them pay, and meanwhile they're earning 14 per cent on their investments," says Commercial Union's Sloan. Another reinsurer adds: "There are some major companies in great shape, as long as they don't have to sell their bonds tomorrow."

Domino effect?

What's more, given the fantastic crisscrossing of reinsurance and retrocession, any reinsurer who is underreserved is going to be a problem to other reinsurers. "Recovery of any big loss like a natural catastrophe or an aviation disaster affect every reinsurance market in the world, including China an the U.S.S.R.," says an intermediary. And so it is not surprising that reinsurers are agonizing about security as they never have before: Will today's reinsurance be collectible tomorrow? A reinsurer is obligated to pay his claims, even if his retrocession fall through. so if enough reinsurance proves uncollectible, many players will assume more loss that they anticipated and perhaps more that they can afford; hence the fear of a domino effect when the next big loss comes along.

Industry giants have been warning for more than a year that as much as 15 to 20 per cent of the reinsurance/retrocession held today may be uncollectible. Slow pay can be as bad as no pay, says Lloyds' Jackson, and going all over the world to collect a loss takes time: "A reinsurer may pay, but he may

be sitting in Bogota, for crissake." The last thing anyone wants to hear, agrees another reinsurer, is, "'There is exchange control in my country, so i cannot get the money to you, or, 'Wait till I collect, then I'll pay you'."

Naturally, no reinsurer will admit to being worried about his own retrocession. Most of the older players say that the new market is the insecure market and that the newcomers all retrocede to each other, having no established retrocessional facilities. Although most long-established reinsurers have found themselves underreserved from time to time, they claim the newcomer is more likely to have inadequate reserves because he's inexperienced and under pressure to show an impressive rate of growth and earnings. A reinsurer must increase his asset base to increase his writings, and the larger his reserves, the smaller his asset base. "Understating your reserves is just another way of overstating your earnings," says one reinsurer. "I don't think it's deliberate: I think many of these people simply don't understand the risks."

When claims start pouring in, point out some observers, the easiest way for reinsurers to hide inadequate reserves is to write still more business, using today's premiums to pay yesterday;s claims and thereby digging their graves still deeper. "A 20 per cent growth in premiums can hide a 15 per cent inadequacy in reserves," says one reinsurance veteran. "Look at how fast some of these new reinsurers have grown."

But the truth is that old reinsurers are also under pressure to show stockholders a good rate of growth and return on investment. And the independent reinsurer may be under even more pressure to retain market share than the company owned by a non-reinsurance parent. "What does the

established reinsurer do when he looks at the market and says, 'It's my main business, and my competition is slashing rates 30 per cent?' He cuts his own rate to hang onto his market, of course," says a newcomer.

At least one longtime reinsurer therefore thinks some major companies will be caught short in the next big loss, and another admits, "You don't know who your reinsurer's retrocessionaries are, and you certainly don't know who's behind them. My feeling is that I want to get my claims in quick" -- before reserves run dry. "The fears about security are most certainly justified,: says General Re's Rondepierre. "Some of today's reinsurance is like the rubber life raft you see on people's boats -- twenty years old and falling apart -- and you ask if they really think they can bet their lives on it and why they bought it, and they say, 'Well, the price was right'."

Market cynics insist that the domino talk is a scare tactic to encourage rate increases, hang onto buyers and chase competition out of the market. While it is true that some major reinsurers may be doing just that -- they desperately want to see the market turn around -- the fact that they are fanning the flames doesn't mean there isn't a fire.

One indication that the security fear is genuine is the current demand for "contingent reinsurance" -- reinsurance just in case present reinsurance falls through "It's crazy," says one intermediary who refuses to place contingent reinsurance. "People come in looking for a contingent cover for $1,000 because they're worried the reinsurance they bought for $10,000 is insecure. Why no have paid $11,000 to begin with?" Adds one underwriter who agrees, "I don't know how you'd price it even if you could justify it conceptually which I can't.

It's just a way of supporting inadequate rates."

But there is a market for contingent reinsurance -- collectible only if the reinsurance fails because of an insolvency resulting from a natural catastrophe -- and not surprisingly, it's in London. "If a risk is really big or really screwy, it still has to go to London," admits an American intermediary.

Another sign of the jumpy state of the market is that the old treaty relationships aren't holding p. "Once, the insurer was prepared to ride out good times and bad with you," says a longtime reinsurer. "Today, we get provisional cancellation notices as a matter of course. The buyer tells you that he's got to show his board he got the best deal, that he's got to shop around." When there was a limited number of reinsurers, an insurer couldn't afford to alienate them; if he abandoned his reinsurer after a loss instead of paying a higher renewal rate, word spread quickly and he couldn't get coverage anymore , says one expert. Today, he adds, the old partnership is turning into a game of buyer beware. And after a player has burned one reinsurer, there's always another to go to.

In a market increasingly characterized by new and untried relationships rather than established loyalties, disagreements are flourishing. There has been an upsurge of arbitration and litigation. One result is that the ambiguities of the standard reinsurance contract arbitration clause have been revealed; there's talk now of redrafting. "If you don't ask the right questions, you don't get the right answers," says one underwriter. There are many in today's market who didn't get the right answers, and cries of "I didn't know we'd written that" have led to litigation. The

Instituto de Resseguros do Brasil, for example, refused to pay the Sasse syndicate at lloyd's more than $3 million of reinsurance claims, contending it didn't know it was reinsuring low-rated high risks -- many of them Bronx fire risks. The risks in question have precipitated suit and counter-suit between Lloyd's and the Sasse syndicate members, as well as between Sasse and IRB.

The computer connection

But the situation that has created the most controversy _____ out of IBM's announcement of a new series of computer _____ announcement triggered a wave of computer lease cancellations and one of the biggest insurance and reinsurance imbroglios to date. Lloyd's underwriters who sold computer leasing insurance face an estimated $225 million in losses -- more than twice their record Betsy losses. On top of that, Federal Leasing of Virginia is suing them for $628 million in punitive damages as well as $30 million in insurance. (Federal Leasing is itself being sued by a Chicago bank that lent money to buy the now outdated computers.) Lloyd's underwriters are counter-suing for $10 million, charging they've already paid Federal Leasing more than they should have, because they weren't given vital claims information.

Another American computer leasing firm, Itel, hopes to recover $100 million in insurance claims from Lloyd's. Itel, meanwhile, has filed a $26 million suite against Americas Insurance Co., from which it bought computer leasing coverage, and against brokers Marsh & McLennan. Americas Insurance reinsured 100 per cent of its Itel coverage, and nine of the reinsurers, including U.S., European and Japanese firms, initially filed suit against Americas Insurance, saying they

had been misinformed of the nature of the risks they were covering. Subsequently, however, the reinsurers dropped the first suit and joined Americas Insurance in its suit against Itel contending that the original policy hadn't been intended to cover the leasing of computers.

The squabbling, blame-placing and jittery fear that are embedded in today's cutthroat reinsurance market all suggest that a collapse and turnaround are imminent. Reinsurers initially hoped that last year's Hurricane Frederic would do the trick -- blow away the shaky competition and leave a solid base of companies to rebuild from. But although Frederic's insured losses are estimated at between $800 million and $1.3 billion, that is still less than Betsy's, given the rate of inflation since 1965. And most of that money, as it happens, will come from primary insurers, not from reinsurers. Frederic would have had to be two and a half to three times bigger to really have an impact on the reinsurance market, says one expert.

No one can say, of course, when a catastrophe of that size will occur, if ever. But even without such an overwhelming catalyst, the experts all agree that the market is too shaky to totter on for long; rates can't keep coming down forever. "When the reinsurers wake up and realize they're losing their shirts, they'll stop supporting cheap primary rates," says one expert. However, the reinsurance market is so much bigger today that its participants are very aware that this time it will take much longer to unravel. Predictions for the turn-around have been pushed back from 1980 to 1981 and some say it won't come until 1982.

When it happens, many reinsurers will disappear, though there are so many participants now that the impact of a large

loss will be diffused, and not as many will be chased out as in past bottoms -- a point that is not lost on the big companies. "That's what we're all afraid of, " says Mercantile & General Re's Gilmore. But the companies that do survive probably will change their way of doing business somewhat; some are already diversifying away from the trying business of writing reinsurance. For example, General Re, conceded to be an industry leader, has within the past year and a half created two subsidiaries to offer management services to clients and according to morgan Stanley analyst Allerton Cushman, recently hired a specialist to give clients tax planning advice. Says General Re's Rondepierre. "We're very seriously in the business of selling services as well as assuming risk."

One other result of the inevitable turnaround is certain: It will have, in the works of one reinsurer, a "tremendous impact on primary insurance rates." That is something corporate risk managers will have to face. It is the price they will be paying for a sounder insurance market. -

continuing development and growth of pools, syndicates, and underwriting mangers. Markets which are not prepared to staff a reinsurance department, may undertake agreements with pool mangers who can provide the expertise necessary to participate in the professional reinsurance community. Pool and syndicate managers assume business for an override and, in many cases, profit commission based upon underwriting results. They may underwrite a port-folio of treaty and/or facultative reinsurance on behalf of their participants who provide financial backing to the management activity. In more stringent market conditions, pools nd syndicates are generally less in favor. They do serve an important role and continue to grow, and present another dimension in the presently expanding market.

A final influence in the expansion is the formation of insurance exchanges. The New York Exchange is operative. The illinois Exchange is in formative stages, and there has been conversation in certain other states regarding such underwriting entities. Thus far, very little new capital has been generated through the formation of the New York Insurance Exchange. Many of the participants are fostered by existing insurance companies which are extending their financial capability into a more person-to-person underwriting facility. The New York Exchange has had some difficulty in developing access to direct business but has become increasingly important for facultative and treaty reinsurance, and international reinsurances which the American market should be looking at more seriously for growth potential.

In the United States the reinsurance intermediary enjoys a strong and growing position in the development of treaty reinsurance. The broker has drawn together in an orderly fashion reinsurance markets of adequate financial strength to create needed

capacity for a variety of reinsurance arrangements. It has been his role to create or fulfill capacity needs in the development of new and existing lines of insurance, and in many cases, this reinsurance capability has allowed pioneers to have great success in new insurance products.

Another role of significant importance is that of monitoring the financial integrity of new and existing markets. The broker must analyze financial statements of reinsurers to make certain that they are capable of insuring the kind of loss expenses which potentially can develop, particularly in catastrophic events.

A reinsurance broker must provide the capability of handling runoffs of cancelled or expired reinsurance arrangements. This is particularly true when the business has a long period of loss development. In some cases reinsurers may be active in the claims and mush of the work in orderly coming of the claims files falls upon the reinsurance intermediary.

The developing market for the reinsurance assumed and the role of the broker has been outlined above. In today's climate, there are certain obligations which the intermediary must assume that are a bit different than in the past. Many of the foreign reinsurers establishing an activity in the United States have, in years gone by, not utilized the resources of a reinsurance intermediary in their ceded and assumed reinsurance efforts. In many areas, the foreign reinsurance market has either produced its business direct or has relied on reciprocal exchange directly between companies to create capacity and spread of risk, the primary purpose for reinsurance. Upon coming to the United States, these companies almost invariably rely on the services of reinsurance intermediaries, who form an industry not well known to them. There must be great faith and rapport

developed with these new markets so that they will fully appreciate the scope, character, and integrity of sound, well-structured reinsurance brokers.

The broker in today's market is increasingly relied upon to create continuity in the market. These new markets must be brought into situations in a carefully researched way, so that there will not be a precipitous change or redesign of market participation in existing programs.

Fiduciary Relationships

The broker must carefully preserve his fiduciary relationships with his client and reinsurance market. He must do all he can to keep the relationship as sound and fundamental as it has been in the past, regardless of pressures from competitive forces which may modify reinsurance design and pricing.

Because of heavy price competition which prevails at this time, it is most important that the reinsurance broker protect his existing market to the greatest extent possible. There can be great temptation to which capacity for short-term reduction of cost, and this is an area where the experienced well-informed reinsurance intermediary can be very useful to his client companies and his markets.

There is a need now, as never before, for reinsurance intermediaries to bring a measure of order into the marketplace. This would allow newly emerging reinsurers to find a place so they can effectively serve the needs of the insurance industry as capacity requirements grow. It is obvious, based upon development of America's resources and inflationary trends which are very much a part of our daily life, that all available market capacity will be called upon to serve the insurance community. Meanwhile, there must be a careful effort to develop and

prepare the new markets for these needs, while, at the same time, retaining loyalty to existing markets that have been through more difficult cycles.

Broker's Role

In a word, the broker's role in a market such as we see today is, as never before, one that may be best described as responsible. The proper cultivation of the market falls squarely on the shoulders of the professional reinsurance intermediary. He must meet this challenge with an enlightened and studied attitude for it may well be that the success or failure of the remarkable emerging reinsurance market potential in the United States will depend on the manner in which the broker performs his role as the catalyst in creating and maintaining capacity.

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company, Plaintiff,	)	
vs.	)	File No. 3 90 0581
E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, and FRANK S. WILKINSON, General Partner, Defendants.	)	

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF'S OBJECTIONS TO REPORT AND RECOMMENDATION OF FEBRUARY 24, 1993

I. INTRODUCTION

Plaintiff, Cherokee Insurance Company by and through, David S. Weed, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company ("Cherokee") respectfully submits this Memoranduim of Law in Support of its Objections to the Magistrate's Report and

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Recommendation of February 24, 1993. (attached hereto as Exhibit 1) (herinafter referred to as "Report and Recommendation" and cited to as "Rep. p. ___"). In the Report and Recommendation, the Magistrate incorporates by reference the "conclusions of law set forth in his earlier Report And Recommendation" entered on February 6, 1992. (Rep. p. 4) The Magistrate concludes that "Cherokee's Motions for Summary Judgment and to Reconsider have failed to present sufficient evidence necessary to overturn the earlier Report and Recommendation." (Rep. p. 5) The Magistrate thereupon recommends "Blanch's motion for summary judgment should be granted with respect to all of Cherokee's claims against Blanch." (Rep. p. 5)

II. ARGUMENT

In the Report and Recommendation

entered on February 6, 1992, (attached hereto as Exhibit 2), the Magistrate deduces from the pertinent case law that the following issues must be resolved in fabor of the movant prior to summary judgment issuing:

(1) Has the moving party "clearly and convincingly" established the absence of material facts;

(2) If so, does the Plaintiff present sufficient facts to establish all the elements of the asserted claim or defense;

(3) If factual support is presented by the non-moving party, are those facts sufficiently plausible to support a jury verdict or judgment under the applicable law?; and

(4) Are there any genuine factual issues with respect to those material facts under the governing laww? (Report and Recommendation, February 6, 1992, p. 27)

Cherokee objects to the Magistrate's resolution of the foregoing issues in Blanch's favor. Cherokee contends that Blanch has failed to meet its burden of showing "clearly and convincingly" the

absence of any genuine issues of material fact" as required bu Sims v. Memphis Processors, 926 F.2d 524, 526 (6th Cir. 1991). See also Martin v. Kelly, 803 F.2d, 239 (6th Cir. 1986). Cherokee has nevertheless "set forth specific facts shoeing that there is a genuine issue for trial" as required by Emmons v. McLaughlin, 891 F.2d 351, 353 (7th Cir. 1989).

Blanch, as a reinsurance broker/intermediary, had a duty to determine the financial viability of the reinsurers with whom it was placing Cherokee's business. See Master Plumbers, Ltd. vs. Cormany & Bird, 255 N.W.2d 533 (Wisc. 1977) (Rep. p.38) The evidence presented by Cherokee is sufficiently plausible to support a judgment against Blanch for Blanch's negligence in securing reinsurance for Cherokee with Mission Insurance Company ("Mission"), Transit Casualty Insurance Company ("Transit") and Mutual Fire Marine and Inland

Insurance Company ("Mutual Fire").

Cherokee therefore respectfully requests for the reasons set forth herin that this Court deny Blanch's Motion for Summary Judgment.

A. Cherokee Objects to the Magistrate's Conclusion that No Competent Evidence exits Creating a Material Factual Dispute as to Whether Blanch Failed to Perform Security Analyses Being Advocated and Performed by Other Prudent Reinsurance Brokers/Intermediaries During the 1980 to 1984 Time Period.

Guy Carpenter & Company, Inc., a reinsruance intermediary comparable to Blanch and a major competitor of Blanch, disseminatedinto the public realm on January 1, 1983, a document it authored setting forth what it perceived to be the prudent standard of care in the industry applicable to itself and its fellow reinsurance intermediaries when conducting security analyses of reinsurance markets. (See Plaintiff's

Memorandum of Law in Response to Defendant's Motion for REconsideration and in Support of Plaintiff's Motion for Reconsideration and Plaintiff's Reply to Defendant's Response in Opposition to Plaintiff's Motion for Reconsideration attached collectively hereto as Exhibit 3). This Guy Carpenter document reflects the security analyses being propounded and utilized by brokers/intermediaries during the 1980 to 1984 time period. The tone of the Guy Carpenter document is indicative of the overall reinsurance industry's emphasis on and understanding of the importance of the issue of reinsurance security.

Prior to Cherokee's discover of the Guy Carpenter document and introduction of the document to the Court, Blanch minimized its duty to conduct security analyses of reinsurance markets and depicted its analysis as quite cursory. Leo T. Heifetz ("Heifetz"), head of Blanch's Market Security

Committee during the time period at issue, testified in his depositionthat Blanch when examining the financial security of reinsurers looked at the following characteristics of the reinsurers: (1) staff; (2) size; (3) A.M. Best rating; (4) NATC Early Warning Test REsults; and (5) ther reinsurer's annual statement. Heifetz denied the performance by Blanch of any in depth financial analysis of potential reinsurance markets. (See Deposition testimony of Heifetz attached hereto as Exhibit 4). Subsequent to the introduction of the Guy Carpenter document, Heifetz however submitted a Second Affidavit wherein he inconsistently expanded on the nature of the security analyses he claims Bolanch was performing. (This Affidavit is attached hereto as Exhibit 5.) In the Second Affidavit, Heifetz basically claims Blanch was during everything Guy Carpenter was during the early 1980's.

Cherokee's expert witness Bernard Webb,

an actuarial and reinsurance consultant, believes a reinsurance broker/intermediary has a duty to financially analyze and continually monitor the financial stability of the reinsurers with which it places a ceding company;s business. (See Affidavit of Bernard Webb attached hereto as Exhibit 6). Mr. Webb, as an actuary capable of analyzing the financial statements of reinsurers, suggests several ratios and factors that may be utilized to educate and inform a reinsurance broker/intermediary as to agiven reinsurer's financial weaknesses.

Mr. Webb contends that if a reinsurer has over 75% of policyholder's surplus represented by reinsurance recoverables, the reinsurer may be financially troubled; and, the reinsurer's Schedule F (a portion of the reinsurer's Annual Financial Statment) shold be reviewed to discern the quality of the retrocessionaires. (The reinsurers of the reinsurer). (See Exhibit 6). According to

Heifetz's depostion testimony, Blanch did not test the relationship between reinsurance recoverables and policyholders' surplus and did not examine the reinsurer's Schedule F's. (See Heifetz's Deposition testimony attached hereto as Exhibit 7). Mr. Webb concludes that that Blanch was negligent not to do so. (See Exhibit 6) If Blanch had conducete such and examination it would have known that Mission, Mutual Fire and Transit were financially troubled at the time Blanch placed Cherokee's business with them. (See the Shcedule F's attached hereto as Exhibit 8).

Mr. Webb further contends that if a reinsurer has over 50% of policyholder's surplus represtnted by investments in subsidiaries, the actual value of the subsidiaries should be examined. (See Exhibit 6). Heifetz testified in his deposition that Blanch did not examine the relationship between a reinsurer's

policyholder's surplus and the reinsurer's investment in subsidiaries, and did not attempt to discern the value of any of the subsidiaries listed by a reinsurer in its financial statment. (See Heifetz's deposition testimony attached hereto as Exhibit 7). Again Mr. Webb concludes that Blanch was negligent not to do so. (See Exhibit 6).

The importance of these ratios and factors suggested by Mr. Webb is easily understood. Obviously, if the bulk of a reinsurer's policyholder's surplus is made up of a discretionary dollar amount the reinsurer attributes to the value of ist subsidiaries, brokers/intermediaries exercising due care should examine the strength of these subsidiaries in an effort to protect its clients and ensure the financial security of the reinsurer. Also, if the bulk of a reinsurer's policyholders surplus is comprised of reinsurance

recoverables, the brokers/intermediaries exercising due care need to investigate the quality of the reinsurance recoverables. If these recoverables are with bogus or financially unstable retrocessionaires, ther reinsurer's asset is in actuality nonexistent.

Blanch has contended throughout the course of this litigation that a reinsurance broker/intermediary is exercising due care if it places reinsurance with a reinsurer based upon the sole criteria that the reinsurer; (1) is solvent at the time of placement; (2) is licensed by independent authorities; and (3) possesses a favorable A.M. Best & Co. rating. Blanch has continually attached the ratios advocated by Bernard Webb as tools for detecting the financial pitfalls of reinsurers as unaccepted inthe industry during the 1980 to 1984 time period and as being dysfunctional. Ironically, however, Heifetz in his Second Affidavit concedes the

use by Blanch of several of Mr. Webb's ratios including the following: (1) Heifetz claims Blanch utilized IRIS ratio 3. Mr. Webb's ratio of reinsurance commissions to policyholder's surplus is very similar to IRIS ratio 3. Furthermore, Mr. Webb's ratio of unearned premiums on reinsurance placed with nonaffiliates is a factor included in IRIS ratio 3.; (2) Heifetz claims Blanch examined the retrocessional facilities of the reinsurers. Mr. Webb's ratio fo unearned premiums on reinsurance placed with nonaffiliates would be reflected in an examination of such retrocessional facilities.' and, (3) Heifetz claims Blanch utillized IRIS ratio 8. Mr. Webb's ratio of agency blances to policyholder's surplus is very similar to IRIS ratio 8. (See Third Affidavit of Bernard Webb attached hereto as Exhibit 9).

Cherokee strongly urges the Court to look to the competent evidence which exists

and discern thereby the existence of a material factual issue as to whether Blanch was performing the security analyses being advocated by other prudent reinsurance brokers/intermediaries and general industry sources during the 1980 to 1984 time period. Mr. Webb insists that if Blanch had been exercising due are and performing the financial analyses it claims it was performing during the 1980- 1984 time period, it would have recognized the financial instability of Mission, Transit and Mutual Fire; and, would thereupon have conducted a more thorough analyses Cherokee's etriment, these reinsurers as reinsurers of Cherokee's business. (See Exhibits 8 and 9).

B. Cherokee Objects To The Magistrate's Conclusion That No Competent Evidence Exists Creating a Material Factual Dispute as to Whether Blanch Knew or Should Have Known of the Financial Instabiolity of Mission Insurance Company (hereinafter referred to as "Mission") When Blanch Placed Cherokee's Business with Mission.

Mission was not historically involved inthe reinsurance busniess. Mission originated as a worker's compensation insurer, and chose to enter into the reinsurance busniess in 1980. Despite Mission's naivete, Blanch placed 25% of Cherokee's main working treaty "The Combined Property and Casualty Excess of Loss reinsurance Treaty" with Mission in 1982, and again in 1983 and 1984.

"Failed Promises, Insurance Company Inxolvencies," a report by the Subcommittee in Oversight and Investigation of the Committee onEnergy and Commerce, U.S. House of Representatives, 105 Congress 2d Session, February 1990," ("the Dingell Report") blames Mission's failure on "poor underwriting, severe underpricing, gorssly inadequate reserving, accounting gimmicks, false reporting and overall disregard for the well being of Mission and the constraints of the marketplace." (The Dingell Report is

attached hereto as Exhibit 10). The Dingell Report also stated with regard to Mission that it had a "solid reputation" and high Best rating until it began an excessive reliance on reinsurance about 1980."

The documents possessed by Blanch as early as 1980 indicated Blanch was in fact aware of some of the problems detected by the Dingell Report. In a "Sales and Service Bulletin" disseminated within Blanch dated October 29, 1980, the "marketing guide" defined Pacific re (an underwriting manager for Mission) as "aggressive and cheap." (This Marketing Guide is attached hereto as Exhibit 11). Also, Cherokee's expert Bernard Webb contends that based upon the financial data on Mission available to Blanch during the 1980 to 1984 time period, Blanch knew or should have known of the financial weaknesses of Mission. (See Exhibits 6 and 9). Contrary to the Magistrate's finding, competent evidence exists which creates a

material factual issue as to whether blanch knew of should have known of the financial instability of Mission when it placed Cherokee's business with Mission.

C. Cherokee Objects to the Magistrate's Conclusion That No Competent Evidence Exists Creating a Material Factual Dispute as to Whether Blanch Knew or Should Have Know of the Financial Instability of Transit Casualty Insurance Company (hereinafter referred to as "Transit") When Blanch Placed Cherokee's Reinsurance with Transit.

Transit began doing business in 1945 as a transportation company. In 1978, Transit entered the reinsurance busniess. Again, despite Transit's naivete, Blanch placed 50% of Cherokee's Commercial Umbrella Treaty with Transit in 1983 and again in 1984. In 1985, Transit was placed under Supervision by the Insurance Department of Missouri. The Dingell Report found that the problems which led Transit's demise were "management incompetence, excessive reinsurance, and

reckless expansion. . ." (See Exhibit 10). Transit's Schedule F's available as early as 1982, show Transit's excessive reliance onreinsurance. (See Exhibit 8). Several of Transit's problems set forth in the Dingell Report were easily detectable by Blanch when Blanch chose to place Cherokee's business with Transit in 1983 and 1984. According to Bernard Webb's examination of the financial data available on Transit during the 1980 to 1984 time period, Blanch knew or should have known of the financial instability of Transit. (See Exhibits 6 and 9). Transit's inexperience as a reinsurer, its financial information available during the time at issue, and the testimony of Bernard Webb, constitute competent evidence that Blanch knew or should have known of the financial instability of Transit.

D. Cherokee Objects To The Magistrate's Conclusion That No Competent Evidence Exists Creating a Material Factual Dispute as to

Whether Blanch Knew or Should Have Known of the Financial Instability of Mutual Fire Marine & Inland (hereinafter referred to as "Mutual Fire") When Blanch Placed Cherokee's Business With Mutual Fire.

Mutual Fire incorporated as a transportation insurance company exclusively. It did not enter the reinsurance business until the late 1970's. Again, despite Mutual Fire's naivete, in 1983 and 1984, Blanch placed 100% of Cherokee's financial guaranty insurance program with Mutual Fire. According to Bernard Webb, as early as 1979, Mutual Fire's financial statement showed an alarming reliance by Mutual Fire on reinsurance. (See Exhibit 6). Mr. Webb insists that based upon the financial information available at the time, blanch knew or should have known of the financial instability of Mutual Fire. (See Exhibits 6 and 9).

Furthermore, based upon the

documentation maintained by Blanch, it appears Blanch knew and merely suppressed such knowledge despite the disastrous consequences to Cherokee. Blanch noted its general concerns about the financial strength of Mutual Fire in a January 11, 1983 Personal Visit Report, wherein Blanch employee Wilkinson following a meeting with the UMI group (which in essence is Mutual Fire), voices "some concerns. . .about the financial viability of this company if it has to weather very severe financial storms. This is something we need to continually watch." (our emphasis) (See Exhibit 12). Also, in a Personal Visit Report, dated January 27, 1983, a "Blanch employee noted regarding his recent visit with Mutual Fire: "A very pleasant meeting. I would like to do more business with these people. They seem to want to become professional reinsurers." (our emphasis) (See Exhibit 13). And finally, another blanch document indicativeof

Blanch's concerns is a Personal Visit Report, dated January 4, 1983, whereto Blanch remarks:

> "Ned (Vice President of Mutual Fire) has big plans for the future and would like EWB Co's help. The only thing that we must be careful of, is that Ned's plans aren't too big, too fast . . " (See Exhibit 14)

Obviously, Blanch had doubts about the quality and strength of Mutual Fire, and such doubts should have prevented Blanch from placing 100% of a Cherokee treaty with Mutual Fire.

The financial information available on Mutual Fire, the testimony of Bernard Webb and the documentation maintained by Blanch constitute competent evidence sufficient to create a material factual dispute as to whether Blanch knew or should have known of the financial instability of Mutual Fire when Blanch placed Cherokee's business with Mutual Fire.

E. Cherokee Objects To The Magistrate's Conclusion That The Undisputed Evidence Is That The Entire Industry - Regulators, Rating Services, Other Insurance Companies, Auditors and Brokers - Was Unaware of the Financial Instability of Transit, Mission and Mutual Fire During the 1980 to 1984 Time Period.

Cherokee's expert, Bernard Webb concludes based upon the financial information available during the 1980-1984 time period on Mission, Transit, and Mutual Fire that the reasonable reinsurance broker/intermediary knew or should have known of the financial impairment of these companies and their impending inability to pay claims. (See Exhibits 6 and 9). Merely because Mr. Webb cannot specifically name an industry source who recognized the financial weaknesses of these companies does not mean that one does not exist. Cherokee argues that based upon the financial information available at the time that the failures of Mission, Transit, and Mutual Fire did not,

contrary to Blanch's assurances, take the entire industry by surprise.

Furthermore, the Dingell Report reveals that Mission and Transit both had problems easily detectable by the insurance and reinsurance communities during the 1980 to 1984 time frame. And, the documentation maintained by Blanch pertaining to Mutual Fire and Mission is indicative of the fact that Blanch was at least one member of the industry aware of the financial impairment of these reinsurers.

F. Cherokee Objects to the Magistrate's Conclusion that the Undisputed Evidence is that Reasonable reinsurance Brokers/Intermediaries Were Not Using the Financial Analyses Propounded by Cherokee's Expert Witness, Bernard Webb.

Bernard Webb's testimony concurs with the security analyses propounded by Guy carpenter as well as the ideas and views expressed in the trade press during the early 1980's. During the early 1980's, the

client/cedant, the reinsurance broker/intermediary and the general public recognized the duty on the part of the reinsurance brokerintermediary to be thoroughly analyzing the financial strength of the reinsurance markets it was choosing for the client. The role of the reinsurance broker/intermediary to thoroughly analyze reinsurance markets was especially recognizable in a situation similar to the one existent between Cherokee and Blanch wherein Blanch was repeatedly making assurances that the reinsurance markets were financially strong. (See Exhibit 6). Bernard Webb has continually stressed the importance of the reinsurance broker/intermediary's analysis of the reinsurance with which it places a client's business. Mr. Webb as an actuary qualified to analyze insurance and reinsurance companies is qualified to suggest ratios and factors helpful in detecting the financial

weaknesses of insurance and reinsurance companies. The ratios and factors which he advocates are very similar to the ones Guy Carpenter advocated in the early 1980's. Blanch's contentions that the ratios and factors Mr. Webb suggests were not the ones reasonable reinsurance brokers were using in 1980-1984 are unfounded.

The important role of the broker/intermediary in not only aiding in the future of the cedant but in aiding in the future of the entire reinsurance industry was discussed on the front page of the "National Underwriter" on December 5, 1980, in an article entitled "Be Brokers: Stronger Role". The article states:

> In the United States the reinsurance intermediary enjoys a strong and growing position in the development of treaty reinsurance. The broker has drawn together in an orderly fashion reinsurance markets of adequate financial strength to create needed capacity for a variety of reinsurance arrangements. It has been his role to create or fulfill capacity

needs in the development of new and existing lines of insurance, and in many cases, this reinsurance capability has allowed pioneers to have great success in new insurance products.

Another role of significant importance is that of monitoring the financial integrity of new and existing markets. The broker must analyze financial statements of reinsurers to make certain that they are capable of insuring the kind of loss expenses which potentially can develop, particularly in catastrophic events. . .

In a word, the broker's role in a market such as we see today is, as never before, one that may be best described as responsible. Ther property cultivation of the market falls squarely on the shoulders of the professional reinsurance intermediary. He must meet this challenge with an enlightened and studied attitude for it may well be that the success or failure of the remarkable emerging reinsurance market potential in the United States will depend on the manner in which the broker performs his role as the catalyst in creting and maintaining capacity. pp. 14-15, (See Exhibit 15)

Blanch throughout this litigation has attempted to minimize the duty of the

reinsurance intermediary/broker to financially analyze reinsurers despite the views being express in the trade press and the overall unrest in the insurance/reinsurance marketplace during the 1980 to 1984 time period. Blanch has argued the importance of the A.M. Best ratings. In 1981, Heifetz sent a memo to the Market Security Committee which states:

> The following markets have a questionable status for any variety of reasons: financial performance, staff, underwriting, attitude; conceivably their effectiveness and acceptability are masked by an acceptable Best's rating. . . (See Exhibit 16).

Blanch recognized the fallacies contained in the Best ratings and Blanch certainly realized that to rely on A.M. Best ratings would be impurdent and ultimately detrimental to the client. Ultimately, Blanch's attempts to minimize the role and duties of the broker/intermediary are nonsensical.

The overall unrest in the insurance and reinsurance marketplace, the general recognition of the increased importance the role of the reinsurance broker, and the factors and ratios being advocated by Guy Carpenter compreise competent evidence creating a material facutal dispute regarding whether the factors and ratios being suggested by Bernard Webb were being used during the 1980 through 1984 time period.

G. Cherokee Objects to the Magistrate's conclusion that No competent Evidence Exists Creating a Material Factual Dispute As to Whether the Insurance Industry as a Whole Was Negligent for Failure to Detect the Financial Instability of Transit, Mission and Mutual Fire; and, Cherokee Further Objects To The Magistrate's Conclusion That No Competent Evidence Exists Creating A Material Factual Dispute as to Whether The Entire REinsurance Brokerage Community Was Negligent In Its Financial Analysis of Reinsurance markets It Was Placing Business With During The 1980-1984 Time Period.

The financial information available for

Transit, Mission and Mutual Fire during the 1980 to 1984 time period creates a material factual dispute as to whether if the industry did not detect the financial instability of Transit, Mission and Mutual Fire, it should have. Blanch cannot excuse itself for failing to discern the financial weakness of Mission, Transit and Mutual Fire merely based upon a contentionthat no one inthe industry recognized such weaknesses. The entire reinsurance community may have been negligent- Blanch included. The law is well settled that:

> No group of individuals and no industry or trade an be permitted by adopting careless and slip shop methods to save time, effort or money, to set its own uncontrolled standard at the expense of the rest of the community. It follows therefore that whenever the particular circumstances, the risk or other elements in the case are such taht a reasonable man would not conform to the custom, the actor may be found negligent inconforming to it; and whenever a reasonable man would depart from the custom, the actor may be found not to be negligent in so

departing. Restatement Second of Torts §295A, p. 62.

If the criteria Blanch urges the Court to accept as reasonable care under the circumstance for brokers/intermediaries when selecting a reinsurance market for a client was the generally accepted custom and practice from 1980 to 1984, then the entire brokerage community was infact negligent. The criteria that the reinsurers be (1) solvent at the time of placement; (2) licensed by independent authorities; and, (3) possess a favorable A.M. Best rating; are entirely to simplistic, "Solvent" is very amorphous term. LIcensing by overworked State regulators is not a dependable indication of financial strength. and, A.M. Best Company itself disclaims its ratings. In its brochures and marketing tools Blanch describes its role as "all encompassing. "For instance, in the late 1970's blanch states in a brochure provided Cherokee:

> Thus as a reinsurance intermediary, E.W. Blanch Co. assumes an all-encompassing role, providing sound counsel, designing and negotiating reinsurance programs and placing reinsurance with strong, responsive reinsurance markets. These programs are monitored on a continuous basis with subsequent recommendations for changes which not only reflect clients' needs but also reflect availability of new coverages in the reinsurance marketplace. (See Exhibit 17).

Blanch recognized its responsibilities as did other reinsurance brokers/intermediaries. If all the reinsurance brokerage community was doing despite its many assurances was looking to characteristics of reinsurers tht any lay person could look to, the entier reinsurance brokerage community ws negligent.

III. CONCLUSION

For the foregoing reasons, Cherokee requests that the Court determine that genuine issues of material fact exist; and,

therefore that Cherokee's claims against blanch should not be summarily denied.

Respectfully submitted,

WEED, HUBBARD, BERRY, & DOUGHTY

By: _____
William B. Hubbard (2770)

_____
Brenner L. Van Meter
Suite 2006
Third National Fin. Ctr.
424 Church Street
Nashville, TN 37219
(615) 251-5444

CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing Memorandum has been forwarded by first-class mail, postage prepaid to: Mr. Daniel P.O. Keefe and John Orenstein, Dorsey & Whitney, 2200 First Bank Place East, Minneapolis, Minnesota, 55402;

and Mr. Jay Bowen, First American Center, Nashville, Tennessee, 37238, on this the _____ day of April, 1993.

_____

William B. Hubbard (2770)

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company, Plaintiff,	)	
vs.	)	File No. 3 90 0581
E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, and FRANK S. WILKINSON, General Partner, Defendants.	)	SECOND AFFIDAVIT OF LEO T. HEIFETZ

Leo T. Heifetz, being first duly sworn, upon oath deposes and states as follows:

1. I am a Senior Vice President at E.W. Blanch Co. ("Blanch"), 3500 West 80th Street, Minneapolis, Minnesota. I have personal knowledge of the facts set forth below.

2. In August of 1991, I had my deposition taken in this action. At that time, I described my involvement with the

Market Security Committee at Blanch. I was the chairperson of that committee throughout the 1981 to 1984 time period.

3. The Market Security Committee developed and "approved market" list, which identified for internal purposes the reinsurers that Blanch brokers could consider proposing to ceding companies. among the criteria used by the Market Security Committee in developing the approved list was the financial strength of the reinsurers. In determining the financial strength of reinsurers, the Committee looked at a variety of factors. These factors or criteria included the size of the company (its policyholder surplus); the rating given to the company by A.M. Best Company, as well as the Best narrative report on the company; the commitment of the company's ownership to the business; the National Association of Insurance Commissioners (NAIC) early warning or IRIS test results; the quality and

experience of the reinsurer's personnel; and an analysis of the reinsurer's annual financial statements, including use of a variety of trade ratios.

4. In conducting this review of the financial strength of reinsurers, the Committee, and Blanch personnel assisting the Committee, prepared certain forms setting forth data relating to reinsurers. Attached hereto as Exhibits A-C are copies of various forms used by the Market Security Committee to record information concerning reinsurers. Exhibit A, entitled "Reinsurer Analysis", was used at least during the 1980-1982 time period. Exhibit B, entitled "Reinsurer Annual Statement Financial Data", we used during the 1982-1984 time period. Exhibit C, also entitled "Reinsurer Annual Statement Financial Data", was used at least in analyzing 1984 financial data.

5. I have reviewed the document entitled "Reinsurance Security", which is

Exhibit 1 to the Affidavit of Brenner VanMeter, and which purports to be a document prepared by Guy Carpenter & Company, Inc., dated january 1, 1993. I have never seen this document before being provided a copy by Blanch's counsel, and I cannot authenticate whether it is what is purports to be. I have reviewed the document, however, to compare the review of reinsurers allegedly conducted by Guy Carpenter as described in that document with the review done by the Blanch Market Security Committee during the 1981 to 1984 time period. The factors identified in the alleged Guy Carpenter document are similar if not identical in most respects to information reviewed by the Blanch Market Security Committee, and the Blanch Market Security Committee also considered additional information not identified in that document.

6. Page 1 of the alleged Guy Carpenter document indicates that Guy Carpenter utilized reinsurers with minimum policyholder

surplus of $10.000.000 for property business and $20.000.000 for other reinsurance. Blanch had similar minimum policyholder surplus criteria during the 1981-1984 time period. The reinsurers involved in the present case, Mission, Transit, and Mutual Fire, all had a policyholder surplus well in excess of $20,000,000 at the time of each placement and renewal. The alleged Guy Carpenter document also indicates that Guy Carpenter normally required a Best's Rating of "A" or better. Each of their reinsurers involved the present litigation had a Best's Rating of "A" or better at each placement or renewal.

7. On the second page of the alleged Guy Carpenter document, the document states that Guy Carpenter's Market Security Committee considered 12 "points" when reviewing each market or reinsurer.

These points are similar or identical to factors also considered by the Blanch Market

Security Committee, as described below:

a. Point 1 is the size of the reinsurer in terms of policyholder surplus or equivalent net worth. Blanch too looked at policyholder surplus ("PHS"), as indicated above and as reflected in Exhibits A-C.

b. Point 2 is the volume of premiums written in relation to net resources. This ratio is the same as ratio No. 1 of the Early Warning System ("EWS") or IRIS tests used by the National Association of Insurance Commissioners (NAIC), which Blanch used in reviewing reinsurers, as reflected in Exhibit A.

c. Point 3 is the amount of reserves for losses, loss adjustment expense, and unearned premium, in relation to net resources and net premiums. This information also was reviewed by the Blanch Market Security Committee, as reflected in part VI of Exhibits B and C.

d. The fourth point is underwriting performance and trends. The IRIS or Early Warning System test No. 4, which was considered by Blanch, was a test of underwriting performance and trends. Moreover, Exhibits A-C identified underwriting performance and trends of the reinsurer.

e. The fifth point is mix of business. The narrative report published by A.M. Best Company, which was reviewed by the Market Security Committee, described the mix of business of companies such as Mission, Mutual Fire, and Transit. Moreover, as reflected in Exhibit A, the Committee took note of the reinsurer's desired types of business and gross line commitments.

f. Point 6 is loss reserve development trends. IRIS test Nos. 9-11 tested loss reserve development trends and were used by Blanch. Moreover, Exhibits A-C recorded loss reserve development trends. For example, Exhibit A set forth the loss ratios for the past five years. Exhibits B and C similarly provided three-year historical data on loss development.

g. Point 7 is investment portfolio with respect to liquidity, diversification and maturity. IRIS test No. 7, used by the Blanch Market Security Committee, was designed to test the reinsurer's investment portfolio. Moreover, as reflected in Exhibits B and C, the Blanch Market Security Committee reviewed the extent to which assets of their reinsurer were in cash, bonds, stock in subsidiaries, and other stock.

h. Point 8 is investment income in relation to gross premiums. This is the same as IRIS test No. 4, relied upon by Blanch, and also is information recorded in Exhibit B, part IV.

i. Point 9 is analysis of cash flow of operations. The alleged Guy Carpenter document does not describe the type of cash flow analysis contemplated. Exhibit B sets forth changes from the prior year to the current year with respect to cash and other assets and liabilities of the reinsurer.

j. Point 10 is loss paying margin, the ability of the company to absorb an unusual shock. As reflected in Exhibit C, Blanch in analyzing 1984 financial data included a separate section on loss paying margin. Prior to that time, Blanch reviewed information that reflected the ability of the company to absorb an unusual loss, as

reflected in Exhibit B, such as the company's assets, and its net worth or policyholder surplus.

k. Point 11 indicates that Guy Carpenter purportedly analyzed underwriting and investment result trends over the prior five years. The Blanch Market Security Committee in assessing reinsurers also reviewed the companies' trends over multiple year periods. For example, as reflected in Exhibit A, blanch reviewed the reinsurer's loss and expense trends over the preceding five years. similarly, as reflected in Exhibit B, the Committee analyzed a variety of trends over a three-year period of time, including changes in policyholder surplus, changes in a number of trade results, and loss development trends.

l. Point 12 is a review of management's record and reputation in the industry and the extent of the company's commitment to the reinsurance business. These too were factors considered by the Blanch Market Security committee. The information is recorded in the A.M. Best Company Narrative Report, and also was recorded to some extent in Exhibit A, page 2. blanch also attempted to keep records of the extent to which reinsurers accepted or declined business, which reflected their commitment to the reinsurance business. The Committee also obtained input from its brokers and trade publications to assess the companies' record and reputation in the industry.

m. In addition to the 12 points listed on page 2 of the alleged Guy Carpenter document, the document also indicated that Guy Carpenter allegedly ascertained reinsurance underwriting philosophy and

capacity, classes of business, and retrocessional arrangements. As reflected on the second page of Exhibit A, this also was information reviewed by the Blanch Market Security Committee.

8. In reviewing the information similar to that set forth in the alleged Guy Carpenter document, as well as the other information identified in Exhibits A-C, the Blanch Market Security Committee determined that Mission, Transit, and Mutual Fire should be included on Blanch's approved list. I am not aware of any other reinsurance broker, including Guy Carpenter, that excluded these companies from their approved lists during the 1980-1984 time period.

9. Although Blanch internally conducted the review described above and reflected in Exhibits A-C in developing its approved list of reinsurers, Blanch and the industry in general also relied heavily upon state insurance regulators and the A.M. Best Company to analyze and determine the financial strength of reinsurers. The

various state insurance regulators and A.M. Best Company conducted, or were understood by Blanch and other industry members to have conducted, an in depth review of the financial condition of insurance companies, including Mission, Transit and Mutual Fire, which review wold have included an analysis of the factors set forth in the alleged Guy Carpenter document. Blanch understood that the analyses done by A.M. Best Company and state regulators was much more detailed and authoritative than the reviews done either by Blanch or allegedly done by Guy Carpenter, and Blanch, as did the rest of the industry, relied heavily upon the results of the analyses of AM Best Company and state regulators, supplemented by Blanch's own review of reinsurers. During the 1980-84 time period, both A.M. Best Company and the state regulators reported that Mission, Transit, and Mutual Fire were viable companies.

10. Cherokee's expert, Mr. Bernard

Webb, purports to have developed a test for predicting the failure of insurance companies, and apparently claims that Blanch was negligent in not using that test during the 1980-1984 time period. Based on my many years in the insurance and reinsurance industry, I am unaware of that test ever being recognized within the industry as a valid predictor of insurance company insolvencies.

Moreover, in order to test the validity of the Webb financial ratios as a predictor of insolvencies, Blanch personnel under my supervision ran those ratios on the nearly 2000 insurance companies on the Blanch computer data base, for which Blanch possesses year 1984 financial data. Those nearly 2000 companies include 20 property/casualty insurance companies that became insolvent after 1984. We determined that the Webb ratios were not a valid indicator of insolvencies.

For example, we found that nearly one-half of the companies, or 984 of the total of 1988 companies, failed one or more of the six Webb ratios. Of those 984 companies, only 14, or less than two percent, subsequently went insolvent. Six, or 30%, of the twenty insolvent companies passed all six Webb ratios. The 970 solvent companies that failed one or more of Webb's ratios included many prominent and sound insurance companies, such as St. Paul, Cigna, Hartford, Aetna, and Crum & Forster insurance companies, and also included many of the best reinsurance companies, such as Kemper Re and Constitution Re.

We also tested whether any one of the six Webb ratios appeared to be valid predictors of insolvencies. None of them do. Ratio #1 predicted the insolvency of only 6 of the 20 insolvent companies, and predicted the insolvency of 638 companies that remained solvent. Ratio #2 predicted the insolvency

of only 4 of the 20 insolvent companies, and predicted the insolvency of 142 companies that remained solvent. Ratio #3 predicted the insolvency of only 4 of the 20 insolvent companies, and predicted the insolvency of 534 companies that remained solvent. Ratio #4 predicted the insolvency of only 5 of the 20 insolvent companies, and predicted the insolvency of 349 companies that remained solvent. Ratio #5 predicted the insolvency of only 10 of the 20 insolvent companies, and predicted the insolvency of 645 companies that remained solvent. Finally, Ratio #6 predicted the insolvency of only 8 of the 20 insolvent companies and predicted the insolvency of 588 companies that remained solvent.

Based on the above data, it seems clear to me that the Webb _____ no validity as a predictor of future insolvencies. Had the test been available to me in 1980-84, which it was not, as chair of the Blanch

Market Security Committee I would not have considered it prudent to use the test to assess reinsurers.

FURTHER AFFIANT SAITH NOT.

_____
Leo T. Heifetz

Subscribed and sworn to before me
this _____ day of _____, 1992.

_____
Notary Public

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company, Plaintiff,	)	
vs.	)	File No. 3 90 0581
E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, and FRANK S. WILKINSON, General Partner, Defendants.	)	

DEPOSITION OF

LEO T. HEIFETZ

VOLUME I

August 22, 1991

9:15 a.m.

Reported by:

KATHY L. SOPER, RPR, CSR
California CSR No. 8519

August of '81.

MR. HUBBARD: Well, if he was a member of the committee from '81 to present, I presume the committee existed. But I really prefer to depose the witness and not you.

MR. O'KEEFE: That's fine, I am not answering any questions here. I just want to know what time period you are talking about. So we are talking August of 1981 right now.

THE WITNESS: Would you mind repeating the question, please?

BY MR. HUBBARD:

Q. Yeah. The question was, how did the committee go about determining the reinsurers that were to go on the list to be utilized:

A. Essentially, we examined certain criteria for the purpose of making that determination.

Q. Okay. And what criteria was that?

A. Staff, size, Best rating, NAIC early warning tests. Those

are the main bullets.

MR. O'KEEFE: Is staff a different thing from size or did you mean to say staff size as one criteria? should there be a comma between staff and size, for the Reporter's purposes?

THE WITNESS: Yes.

BY MR. HUBBARD:

Q. How about the annual reports or annual statements?

A. Yes, if you mean did we examine them.

Q. Yes, as part of the criteria that you used.

A. Yes.

Q. Okay. If we can sort of break those down and sort of talk about what you were looking for in the criteria. We can take

them in the order.

The Staff, what were you looking for when you looked at the staff of these companies?

A. People that worked there that were reasonably experienced in presumed -- the presumption being that they knew what they were doing.

Q. Were your -- was your primary concern there underwriting standards?

A. Yes.

Q. And so you were looking for staff which you thought were -- would be knowledgeable in implementing good sound underwriting standards?

A. That's right.

Q. Size, what were you looking for in size?

A. Well, in terms of policyholders' surplus, we had varying amounts of a minimum standard for property and casualty reinsurance.

Q. Okay.

August 14, 1981

TO: The Market Committee

Markets Requiring Discussion

following markets have a questionable status for any
of a variety of reasons: financial, performance,
if, underwriting attitude; conceivably, their effective-
s and acceptability is masked by an acceptable Best's
ing. Please review this list and give your comments:

American Centennial

American Mutual Liability

Bellefonte

Commercial Union Re

Fremont Indemnity

Pine Top

Presidio

Public Service Mutual

Puritan

Rein. Assoc. of Mn.

Rhineland

Sirius

Unigard

Union Indemnity

Universal Re

Victory Re

Cameron

If there is any market you would like to discuss that is
not shown above, please advise and we will happily include.

Heifetz

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE, TENNESSEE

CHEROKEE INSURANCE COMPANY	)	
	)	
PLAINTIFF,	)	
	)	
vs.	)	Civil
	)	Action
E.W. BLANCH CO., E.W. BLANCH	)	No.
JR., General Partner, MICHAEL	)	3-90-0581
W. CASHMAN, SR., General	)	
Partner, FRANK S. WILKINSON,	)	Judge
General Partner, and PAUL S.	)	Nixon
MAVROS, General Partner,	)	Mag.
	)	Haynes
Defendants.	)	

AFFIDAVIT OF BERNARD L. WEBB

Bernald L. Webb, having been duly sworn according to law states as follows:

1. I am presently employed as an actuarial and reinsurance consultant. My office address is 4841 Mill Brook Drive, Dunwoody, Georgia 30338. I expect to serve as an expert witness for Plaintiff, Cherokee Insurance Company in the above styled matter.

2. For most of my career I have been a teacher. I taught at Georgia State

University from 1967 until 1989. Prior to that I taught some classes at Wisconsin State university from 1963 until 1964. I also taught C.P.C.U. preparation classes from 1956 until 1962 as well s the Georgia Chapter of C.P.C.U. from 1968 until 1987. And lastly, I taught for a short period at the Insurance Institute for Asia and the Pacific in 1982 on behalf of the United Nations.

3. Since 1968 I have been a member of the National C.P.C.U. Examination Panel. From 1961 until 1979, I was a member of the National C.P.C.U. Grading Panel, and since 1966, I have been a member of the American Academy of Actuaries. Also, I was the Director of the Basic Insurance School for the National Association of Professional Insurance Agents in 1980, 1981 and 1982.

4. Since 1988, I have been a consultant to the multi-state Antitrust Task Force. In 1987 and 1988, I was a consultant to the Florida Academic Task Force for the

review of the Insurance and Tort Liability Systems. In 1984, I was consultant to the United Nations Commission on Trade and Development and from 1977 until 1980, I was a consultant to the U.S. Department of Justice. Also, in 1968 and 1969, I was a consultant to the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary of the United States Senate. From 1964 until 1967 I was and Actuarial Specialist for the Hardware Mutual Casualty Company. From 1962 until 1964, I was Executive Secretary of the Insurance Advisory Committee of the City of Richmond, Virginia. From 1953 until 1955, I was the sales correspondent for the Hardware Mutual Casualty Company. Since 1985, I have been the Director of the Physicians' Insurance Company of Michigan.

5. I am a member of the American Academy of Actuaries; The American Risk and Insurance Association; the Casualty Actuarial

Society; the International Actuarial Association; the Society for Insurance research; the Society of Chartered Property and Casualty Underwriters [Past President of the Georgia, Virginia and Northern Wisconsin Chapters; and Past Editor of C.P.C.U. Annals (now C.P.C.U. Journal]; and a member of the Southern Risk and Insurance Association.

6. I obtained a B.S. in Business Administration from the University of Richmond in 1949 and a M.S. in Business Administration from the University of Richmond ub 1964. I became a Fellow in the Casualty Actuarial Society in 1964 and obtained my C.P.C.U. designation in 1956.

7. I was the Robert E. Early Visiting Scholar at the America Institute for Property and Liability Underwriters in 1979 and 1980. I was named the Alumni Distinguished Professor for the College of Business Administration at Georgia State University in

1978. I also received the Ben F. Hadley Award by the Griffith Foundation for Insurance in 1976. I have written many books and articles. (A list of which is attached hereto as Exhibit A)

8. It is my expert opinion that great differences exist between brokers and reinsurance brokers/intermediaries. Direct insurance brokers are primarily sales people, their expertise is in the area of policy coverage and analysis of insurable loss exposures. Few of them have sufficient knowledge of insurance company finance and accounting to assess the solvency and solidity of an insurer. Reinsurance brokers/intermediaries, must by the nature of their business, have an understanding of insurance company finance and accounting. Reinsurance is an important element in an insurer's financial planning. A reinsurance broker/intermediary must understand the effects of reinsurance as on insurer's

finances and accounting statements in order to assist his clients in the design and execution of a reinsurance program. Consequently, the assessment of a reinsurer's solvency and solidity should not be beyond the abilities of a qualified reinsurance broker.

9. Another notable difference is that most direct insurance agencies and brokerage firms are small, and many are very small. One survey of direct agents showed that 93% of respondents wrote less that $7 million in premiums annually, with 72% writing less than $2.5 million. (What It Costs, 1990 Edition, Rough Notes Company, pp. 4-5). Most of this premium income must be forwarded on to the insurer - the agent or broker keeps only his commission, typically about 15% of the premium. At that rate, an agency with $7 million per year in premiums would have commission income of about $1.05 million per year.

10. In contrast, E.W. Blanch Co. had estimated gross revenues (comparable to the commission figure cited above) of $47.2 million in 1989. Its premium volume in 1989 was $940 million. (Business Insurance, November 12, 1990, pp. 3, 10). It is apparent that Blanch has both the financial and personnel resources to make reasonable investigations of the financial strength of reinsurers with which they placed reinsurance. A typical direct insurance agent or broker is lacking in both areas.

11. I will testify that Blanch, being a reinsurance intermediary, had a duty to financially analyze and continually monitor the financial stability of the reinsurers with which it placed a ceding company's, namely Cherokee's, business.

12. My in-depth analysis of the annual financial statements of Mission Insurance Company ("Mission"), Transit Casualty Insurance Company ("Transit"), Universal

Reinsurance Corporation ("Universal Re"), Northwestern National Insurance and Mutual Fire Marine and Inland ("Mutual Fire"), reveals that at the time Blanch placed Cherokee's business with these reinsurers, Blanch either knew or with the exercise of reasonable care, should have known that these companies were financially troubled and represented poor security.

13. If a reinsurer has over 75% of policyholder's surplus represented by Reinsurance Recoverables, the reinsurer may be financially troubled; therefore, the reinsurer's Schedule F (a portion of the Annual Financial Statement) should be reviewed to determine the quality of the retrocessionaires. Blanch did not test the relationship between reinsurance recoverables and policy holder's surplus for the reinsurers to which business was ceded. See Deposition of Leo Heifetz pp. 67, 225. Furthermore, Blanch did not look to Schedule

F to see what retrocessionaires were represented in a reinsurer's reinsurance recoverables. See Deposition of Leo Heifetz p. 70. Blanch was negligent not to conduct such and examination. If Blanch had conducted such an examination it would have known that the reinsurers at issue were financially troubled at the time of placement.

14. If a reinsurer has over 50% of policyholder's surplus represented by investments in subsidiaries, the actual value of the subsidiaries should be examined. Blanch did not test the relationship between the reinsurer's investment in their subsidiaries and their policyholder's surplus. See Deposition of Leo Heifetz p. 71. Blanch was negligent not to test this relationship. If the actual value of the investments in subsidiaries had been examined as regards Mission, Universal Re, and Northwestern National, Blanch would have

known of their financial troubles at the time of placement.

15. Blanch failed to adequately investigate the reinsurers with which it was placing Cherokee's business and thereby breached its duty to provide Cherokee financially sound reinsurers.

_____

BERNARD L. WEBB

STATE OF TENNESSEE:

COUNTY OF DAVIDSON:

Sworn to and subscribed before me this _____ day of September, 1991.

_____

NOTARY PUBLIC

My Commission Expires:

_____

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company, Plaintiff,	)	
vs.	)	File No. 3 90 0581
E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, and FRANK S. WILKINSON, General Partner, Defendants.	)	

DEPOSITION OF

LEO T. HEIFETZ

VOLUME I

August 22, 1991

9:15 a.m.

Reported by:

KATHY L. SOPER, RPR, CSR
California CSR No. 8519

contain ratios.

If you understand the question or would like to have it read back to you, go ahead.

THE WITNESS: Conceivably.

BY MR. HUBBARD:

Q. Conceivably.

A. Well, you were hypothesizing and I am saying that conceivably, yes.

Q. Right. Would you consider reinsurance a very risky part of the insurance market?

A. If you are asking for my personal opinion?

Q. Yes.

A. Yes.

Q. Are there certain ways to artificially increase the policyholder surplus or reflect it by a company?

MR. O'KEEFE: Object on foundation grounds. Object as being beyond

the scope of the notice of examination and as calling for expert testimony, and I also object as vague as to what's meant by the term "artificial."

THE WITNESS: Well, that's the term I was going to question. "Artificial" is --

MR. O'KEEFE: Are we talking about fraud of some sort?

THE WITNESS: -- pretty broad. Yeah, do

So in the context of having a large number of retrocessionaires and a large amount of sessions, and, therefore, a large amount of receivables, which ties back to your questions, I would say that was practiced with -- considerably or frequently and by, presumably, some of the finest security in the world.

BY MR. HUBBARD:

Q. Right.

A. I say presumably because everybody has their opinions about Lloyds.

Q. Sure.

A. So I don't think, in and of itself, you can look at a single portion of an operating statement and say that's bad or that's good.

Q. You don't think that --

A. Furthermore, it wasn't our job.

Q. Okay. Let's take one at a time, if we can. Okay?

A. Okay.

Q. If the -- does the Schedule F of the annual statement list the restrocessionaires?

MR. O'KEEFE: Schedule F?

MR. HUBBARD: Right.

THE WITNESS: That's correct.

Q. If the reinsurance receivables were approaching 100 percent of the

policyholder surplus, would that be a reason to examine Schedule F to see what other companies were going to be looked to to pay those losses?

MR. O'KEEFE: We are talking about today; is that right? Your question is present tense?

MR. HUBBARD: Sure, today.

BY MR. HUBBARD:

Q. What's your opinion?

MR. O'KEEFE: I have the same objection and want to note for the record this is beyond the scope of the notice of examination.

If the witness has a personal view, he can express it. It's not the view of E.W. Blanch Company.

I also object as vague as to who you are referring to in your question when you say whether that would be a reason for someone to look at Schedule F. It's vague as to who that someone was in your question, a person off the street

or a buyer or who it is you have in mind.

THE WITNESS: Could you rephrase your question?

BY MR. HUBBARD:

Q. Sure. Let's see if I can rephrase it.

In attempting to determine the security that a reinsurer would offer, if they are -- if the reinsurer's reinsurance receivables or their retrocession receivables were approaching 100 percent of the policyholder surplus, would that be a reason to examine Schedule F of the annual statement?

MR. O'KEEFE: Same objections and notations for the record and, again, I think your question, as restated, is vague as to who it is you have in mind ought to be looking at Schedule F, a regulator, a broker, a buyer, a who?

THE WITNESS: In and of itself, no.

BY MR. HUBBARD:

Q. Should the quality of the retrocessionaires -- is it necessary ever to examine the quality of the retrocessionaires in order to determine the security offered by the reinsurer?

MR. O'KEEFE: Necessary for whom?

Necessary for a broker, is that your question?

MR. HUBBARD: No, is it necessary for whoever is trying to determine the security of it. I didn't -- the question is complete, unless you

want to read things into it.

MR. O'KEEFE: Wel., I am going to object, again, as v a g u e . Object for the reasons stated previously, that this present tense question as to

what some person in some unstated capacity might want to do in 1991 is beyond the scope of this examination and certainly irrelevant to this litigation.

THE WITNESS: I am not sure that I can give you a good answer to your question, Bill. It's certainly something that I know Best looks into, and I -- but beyond that, I don't know how to answer your question.

BY MR. HUBBARD:

Q. Okay. Did the market security committee look into the investments of the reinsurance companies on the approved list?

MR. O'KEEFE: And what's the time period?

MR. HUBBARD: 1980-'84.

THE WITNESS: No. A modification to

your last question.

BY MR. HUBBARD:

Q. Sure.

A. We did try to produce some information about the amortized value of bonds.

Q. Okay. What about did you attempt to produce any information about the value of investments and subsidiaries?

A. Yes, some.

Q. Okay. Now, when would you do that, and how would you go about it? Just explain it to me, if you could.

MR. O'KEEFE: Object as vague and object as compound.

THE WITNESS: Well, I think I understand you question. Essentially, when we received the convention blank, we would want to make sure that the reinsurer was not pyramiding its assets within subsidiaries.

BY MR. HUBBARD:

Q. Right.

A. And we did that, principally, to make sure that the company or the group of

companies weren't over-leveraged.

Q. Okay. Would you also attempt to look at the value

PERSONAL VISIT REPORT
(MARKET VISITS TO EWB CO.)

COMPANY Mutual Fire, Marine & Inland

PERSONS Mike Reynolds and Ned Bowers

DATE 1/27/83

Areas of Interest:

____ Shifts in underwriting policy. (any interest in specialty covers?).

____ Personnel changes.

____ Complaints or comments about our office.

____ Review of experience on business from EWB Co.

Mike and Ned stopped by our office for about one and a half hours. Mutual Fire just received a "A" rating (class 12). Both Mike and Ned projected a very favorable image of what Mutual Fire intends to do and what the actual are now. They are receptive to writing low layer casualty business (they don't want to write the high excess casualty business) as well as working layer property excess per risk. They are not hot for quota share business currently.

We discussed two specific items:

1. I have forwarded a submission for Republic Western/Capital Workshop Lawyers Professional Liability Programs to Mike. They would like to write a piece of the First Layer (15%). However, they may

have a political conflict due to the fact that, for approximately $20,000,000 of written premium, they front some of the Shand Morhanm professional liability business. In view of the fact that this is an excess treaty, they may be able to get beyond this political hurtle. They have to take it to the president of Mutual Fire for his approval. Mike will be getting back to me.

2. We discussed Jim Keough. Apparently, Mutual Fire does have an interest in fronting business if they can get some ownership in the MCA. I indicated that Jim Keough's operation may fit the bill here and Mutual Fire already write some Marine business down in Florida. The person I should contact is Mr. James Hyde. He is an executive vice president.

Mike also mentioned the name of a company we may want to call on in San Francisco. It is World American Services and the fellow's name is Towney Salmund.

A very pleasant meeting. I would like to do more business with these people; they seem to want to become professional reinsurers.

Graham

rhg 1/28/83

PERSONAL VISIT REPORT
(MARKET VISITS TO EWB CO.)

COMPANY MFMI

PERSONS Ned Bowers

DATE 1/4/83

Areas of Interest:

____ Shifts in underwriting policy. (any interest in specialty covers?).

____ Personnel changes.

____ Complaints or comments about our office.

____ Review of experience on business from EWB Co.

Ned dropped by to begin planning for his reinsurance needs in 1983. Ned firmly believes that between Regulation 98 and the other trends emerging in the reinsurance world, that there will be a major shakedown within the reinsurance industry. With a PES of slightly above $40,000,000, MFMI is neither a large nor a small reinsurer. To insure MFMI's continued presence among the industry leaders, Ned feels they need considerably more capacity and market "clout" and would like to achieve this through some sort of management agreement, Ned would like our help in introducing an A or A+ IV-fully licensed, company to MFMI. This new company would take part of the Companion Line Quota Share Contract (which we place) and to be available for fronting purposes. We need to draw up a list and present it to Ned for his

review.

Also as respects the renewal of the Casualty Quota Share, Ned again hopes to increase the capacity of this agreement. Long term, he would like $1,000,000 in capacity which is an increase of $650,000. We may have to do this over more than two years, but we should begin working on this. This, of course, would require corresponding revisions in the Casualty Accumulation Agreement, but these can't be done until the Casualty Quota Share Statement is in place.

Ned also has large plans abroad. Along the lines of their agreement with Rhine Re in Switzerland. MFMI would like to set up a similar arrangement in both Scandinavia and the Far East. Basically, this would include establishing a reinsurance company in a given local through the combined commitments of several insurance companies. Whether there is an option for Blanch's involvement in this part of their expansion plans, is unclear.

Regarding business with EWB Co., Ned is pleased. They saw a good flow of business from us this year and Ned hopes their service was prompt. Apparently, Ned received some grumbling on this issue. We pointed out that the dropping of UMI Mgm't was probably a good move, especially in light of Reg. 98. Also placing Kansa, etc. as retrocessionaires behind MFMI was certainly a good move from the brokers point of view. It is much easier to use their full lines, as people are becoming increasingly security conscious, when the total line is in MFMI's name.

Conclusion

Altogether this was a good meeting with Ned. Ned has big plans for the future and would

like EWB Co's. help. The only thing that we must be careful of, is that Ned's plans aren't too big, too fast. His thinking is probably correct in that other people will probably begin thinking along a similar path as MFMI, so speed could be of the essence.

August 14, 1981

TO: The Market Committee

Markets Requiring Discussion

following markets have a questionable status for any
of a variety of reasons: financial, performance,
if, underwriting attitude; conceivably, their effective-
s and acceptability is masked by an acceptable Best's
ing. Please review this list and give your comments:

American Centennial

American Mutual Liability

Bellefonte

Commercial Union Re

Fremont Indemnity

Pine Top

Presidio

Public Service Mutual

Puritan

Rein. Assoc. of Mn.

Rhineland

Sirius

Unigard

Union Indemnity

Universal Re

Victory Re

Cameron

If there is any market you would like to discuss that is
not shown above, please advise and we will happily include.

Heifetz

No. 94-5110

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED Plaintiff-Appellant,	]
v.	] On Appeal from the United States District Court for the Middle District of Tennessee
E.W. BLANCH COMPANY, et al Defendant-Appellees.	]

Decided and Filed September 26, 1995

Before: NELSON and SURHEINRICH, Circuit Judges; SMITH, District Judge.

DAVID A. NELSON, Circuit Judge. The issue we address in this appeal is whether the defendant, a reinsurance broker, was entitled to judgment s a matter of law on a claim that it failed to exercise due care in examining the financial strength of certain reinsurers it recommended to the plaintiff insurance company. On cross-motions for summary judgment, the district court resolved this issue in favor of the defendant. We concluded, upon de novo review, that the

district court reached the correct result. The judgment entered in favor of the defendant will be affirmed.

I.

The plaintiff, Cherokee Insurance Company, is a property and casualty insurer incorporated in Tennessee and based in that state. Cherokee was placed in "rehabilitation" (a form of receivership) in July of 1984, after the company encountered problems with its "assumed" reinsurance business -- a line of business in which Cherokee itself acted as a reinsurer.[1] The present lawsuit was filed in June of 1990, at which time Cherokee was still acting by and through David S. Weed as "Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company." (Mr. Weed is also a member of the law firm that represents Cherokee herein.) The action was brought in the Chancery Court for Davidson County, Tennessee.

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[1]Where an insurer obtains reinsurance by ceding a portion of its risk to a reinsurer, the company providing the reinsurance is referred to as the "assuming" company. Cherokee retained only a small part of its assumed reinsurance, passing the bulk of the business on to "retrocessionaires," or reinsurers of reinsurers. Cherokee's main retrocessionaire -- which, like most of Cherokee's retrocessionaires, was an off-shore company -- is said to have stopped fulfilling its obligations late in 1983. The defendant was not involved in the selection of Cherokee's retrocessionaires and is not claimed to have been responsible for Cherokee's going into rehabilitation.

Named as defendants were E. W. Blanch Company, a Delaware partnership, and several individuals identified as general partners of the firm. We shall refer to the partnership and the defendant partners collectively as "Blanch or "the defendant."

Cherokee's complaint alleged among other things, that Blanch had served as Cherokee's principal reinsurance "intermediary," or broker, pursuant to an unwritten contract; that Blanch negotiated arrangements under which Cherokee ceded to various reinsurers some of the risk on insurance policies it had written; that Blanch owed Cherokee a duty to exercise reasonable prudence, diligence and care in selecting financially sound reinsurers and in monitoring their financial stability; that among the reinsurers with which Blanch placed business for Cherokee were five companies that proved to be financially unsound; that Blanch was negligent in the selection of these companies; and that Cherokee suffered damages of approximately $2.5 million as a result of such negligence.[2]

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[2]In September of 1992 Cherokee moved for leave to amend its complaint by dropping all claims against Blanch with respect to two of the five reinsurers. (The motion said that evidence surfacing since the filing of the complaint showed that the two reinsurers were solvent -- "and, therefore, Blanch cannot be held negligent in the placement of Cherokee's business with these two reinsures.") In June of 1993 Cherokee moved for leave to supplement the complaint by increasing its claim of damages with respect to one of the remaining reinsurers. The net amount of damages claimed after these adjustments came to approximately $1.4 million, exclusive of

Blanch removed the case to federal court on diversity grounds pursuant to 28 U.S.C. § 1441. Soon thereafter Blanch filed an answer in which, among other things, it admitted that it had functioned as the intermediary on reinsurance matters involving Cherokee' denied the existence of any contractual arrangement regarding the subject matter of the action; denied having been under the alleged duty of care or having broker any such duty; and asserted a variety of affirmative defenses, including ratification of and/or consent to the conduct complained of, contributory negligence, assumption of the risk, and waiver.

Blanch moved for summary judgment in March of 1991. Six months later Cherokee moved for summary judgment as to liability. In February 1992 a magistrate judge issued a report and recommendation in which he recommended that Blanch's motion for summary judgment be granted in part and denied in part. Both sides moved for reconsideration, expanding the record in the process. In a report and recommendation issued in February of 1993 the magistrate judge recommended allowing Cherokee to drop its claims as to the two solvent reinsurers; denying Cherokee's motion for summary judgment and

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punitive damages. The individual reinsurance companies involved, nd the estimated losses associated with each, are as follows:

-- Mutual Fire Marine and Inland Insurance Co., $558,357.47;

-- Transit Casualty Co., $529,750.00; and

-- Mission Insurance Co., $307,287.00.

motion for reconsideration; granting Blanch's motion for reconsideration; and entering summary judgment in favor of Blanch as to all of Cherokee's claims against it. The district court adopted these recommendations, without change, in an order entered on December 20, 1993. This appeal followed.

II.

The factual picture that emerges from the rather massive record compiled by the parties may be outlined broadly as follows.

Cherokee relied on several intermediaries to obtain reinsurance for it, but Blanch was its principal reinsurance intermediary until 1984. Representative of Blanch would visit Cherokee annually to analyze the company's reinsurance needs for the coming year. Blanch would then work out an agreed reinsurance program with Cherokee, circulate a description of the program to potential reinsurers, and advise Cherokee of the companies with which it proposed to place reinsurance. Blanch typically told Cherokee that the reinsurers it was proposing appeared to offer "good" or "acceptable" security, but Cherokee would be asked to contact Blanch with any questions or comments it might have. Cherokee's silence was assumed to mean approval. Blanch would negotiate reinsurance contracts (or "treaties") with companies participating in the program and would submit contracts signed by such companies for signature by Cherokee.

Blanch's compensation for its services came not from Cherokee, but from commissions on the insurance ceded by Cherokee. Blanch viewed Cherokee as its client, however, and it is clear that Blanch considered itself to be working for Cherokee, not for the

reinsurers.

In a promotional brochure circulated to clients (including Cherokee) at the end of the 1970's, Blanch described its role as an "all-encompassing" one that included "providing sound counsel, designing and negotiating reinsurance programs, and placing reinsurance with strong, responsive markets." (In this context, a "reinsurance market" means an individual reinsurer.) The brochure went on to say that "[t]hese programs are monitored on a continuous basis with subsequent recommendations for changes which not only reflect clients' needs but also reflect availability of new coverages in the reinsurance marketplace."

Blanch monitored the financial strength of individual reinsurers through an internal committee called the Market Security Committee. This committee maintained a confidential list of approved reinsurers that Blanch employees could routinely propose to clients.

In determining whether to place a reinsurer on its approved list during the time period relevant here (1980 to 1984), the committee considered a number of factors commonly used and relied on within the industry. These factors included the rating assigned to the reinsurer by A.M. Best Company, a prominent insurance company rating service; the size of the reinsurer, as measured by its policyholder surplus; "early warning" data involving some eleven financial ratios (subsequently called "IRIS ratios," the acronym standing for Insurance Regulatory Information System) developed by the National Association of Insurance Commissioners; the reinsurer's annual reports; and the reputation of the reinsurer's staff.

The three reinsurers named in footnote 2, supra -- Mutual Fire, Transit Casualty, and Mission Insurance -- qualified for inclusion in Blanch's approved list during the early 1980s. Each of the three carried an "A+" (superior) or "A" (excellent) rating from A.M. Best. Each was of a size that met Blanch's established criteria. Each passed the IRIS test administered annually by state regulatory authorities. Each issued annual reports that set off no alarm bells with the regulatory authorities. None of the three companies, as far as the record discloses, had a reputation for management competence that was anything other than favorable.

Cherokee, whose own staff included qualified professionals capable of forming judgments in this area, raised no question as to the inclusion of any of the three reinsurers in Cherokee's program. In October of 1985, however, Mission Insurance Company was placed under conservatorship. (This happened almost two years after Cherokee's last purchase of reinsurance from Mission.) Transit Casualty and Mutual Fire subsequently went the same route. It is undisputed that all three companies defaulted on their reinsurance obligations to Cherokee.

In attempting to develop support for its claim that Blanch had been negligent in passing these companies on Cherokee's reinsurance treaties, Cherokee engaged Bernard L. Webb as an expert witness. Mr. Webb, who was a teacher at Georgia State University for most of his career, is a Fellow of the Casualty Actuarial Society, a Chartered Property and Casualty Underwriter, and the author of various books and articles on insurance subjects.

In a deposition given in June of 1992, and in three affidavits executed between September of 1991 and September of 1992, Mr. Webb described an in-depth analysis he performed on the annual financial statements of the five reinsurers as to which Blanch was originally claimed to have been negligent. Although he did not assert that any of the companies was insolvent when Blanch placed reinsurance with it, Mr. Webb maintained -- using his analysis as the standard -- that Blanch should have known that the five companies were financially troubled and represented poor security.

Mr. Webb's standard entailed the use of six different financial ratios: the ratio to policyholders' surplus of (1) ceding commissions (a measure of the company's dependence on reinsurers); (2) investment in subsidiaries and affiliates; (3) reinsurance recoverables from affiliates; (4) reinsurance recoverables from non-affiliates; (5) total reinsurance recoverables; and (6) balances due the company from its agents. Mr. Webb assigned a specified pass-fail benchmark to each ratio. If more than 75 percent of the policyholders' surplus was represented by reinsurance recoverables, for example, Mr. Webb expressed the opinion that a review of the quality of the retrocessionaires would be indicated. If more than 50 percent of the surplus was represented by investments in subsidiaries, similarly, he opined that the actual value of the subsidiaries should be examined. Blanch did not perform this type of analysis.

Neither, as far as the record discloses, did any other reinsurance broker in the industry. Mr. Webb, who had never been a broker himself and had never worked for one, claimed no expertise as to industry

practice. He could not identify any brokerage firm that was doing the type of analysis he advocated, and he acknowledged that he did not hold himself out as an expert on the customs and practices of reinsurance brokers during 1980 to 1984.

Mr. Webb could not say, similarly, that any of the ratios employed in his analysis did, in fact, signal an actual cause of the failure of any of the reinsurers in question. He was not retained, he said, to perform a detailed study of why the companies failed, and he did not know whether any of them had failed because of the undue dependence on insolvent reinsurers. He could not say, similarly, what the result would have been if further investigation had been conducted into the areas where he said there were warning signals. That too, he testified, was not a part of his assignment.

Mr. Webb did say, however, that he had made some attempt to search the literature for references to Mutual Fire et al. during the 1980-84 time period. He testified that he found nothing in the literature that reflected adversely on the financial strength of these companies. He further testified that he was aware of no one in the entire insurance industry who was predicting future financial trouble for any of the companies.

Speaking of the financial ratios he had used in his analysis of the failed reinsurers, Mr. Webb stated in his final affidavit that "I have never held my ratios out as predictors of insolvency." The affidavit went on to state that no single group of ratios can predict insolvency, and "I do not ... purport to have developed a test for predicting the failure of insurance or reinsurance companies."

This particular affidavit was filed in response to one provided by Leo T. Heifetz, a senior vice president of E. W. Blanch Company and a sometime chairman of its Market Security Committee. The Heifetz affidavit said that to test the predictive value of Mr. Webb's ratios, Blanch had to run the ratios on the 1984 financial data of the nearly 2000 insurance companies in Blanch's computer data base. These companies included 20 property/casualty insurance companies that became insolvent after 1984. The exercise showed, according to Mr. Heifetz, that the Webb ratios were not a valid indicator of insolvencies:

> "For example, we found that nearly one-half of the companies, or 984 of the total of 1988 companies, failed one or more of the six Webb ratios. Of those 984 companies, only 14, or less than two percent, subsequently went insolvent. Six, or 30% of the twenty insolvent companies passed all six Webb ratios. The 970 solvent companies that failed one or more of the Webb's ratios included many prominent and sound insurance companies, such as St. Paul, Cigna, Hartford, Aetna, and Crum & Forster insurance companies, and also included many of the best insurance companies, such as Kemper Re and Constitution Re."

Mr. Webb did not challenge the accuracy of these assertions.

The Heifetz affidavit also discussed a document prepared by another reinsurance intermediary, Guy L. Carpenter & Company, in which that company described the factors it reviewed in assessing the financial strength of reinsurers with which it placed business

for clients.[3] Mr. Heiftz made a detailed showing -- also unrefuted by Mr. Webb -- that the factors considered by Guy L. Carpenter in reviewing reinsurers were comparable to the factors considered by Blanch's Market Security Committee. And "I am not aware, " Mr. Heifetz said, "of any other reinsurance broker, including Guy Carpenter, that excluded [the reinsurers at issue here] from their approved lists during the 1980-1984 time period."

The Heifetz affidavit says that the entire industry relied heavily on state insurance regulators and the A.M. Best Company to review and analyze the financial condition of insurance companies in depth. "During the 1980-84 time period," Mr. Heifetz stated, "both A.M. Best Co. and the state regulators reported that Mission, Transit and Mutual Fire were viable companies."

The magistrate judge, adopting a factual summary offered by Blanch, said that

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[3]The Guy L. Carpenter document began with a warning that reinsurance intermediaries are not guarantors, but acknowledged that they are responsible for using good judgment:

> "As reinsurance intermediaries, we are not, of course, in a position to guarantee the security of any reinsurer; however, we do fully recognize our responsibilities to assist our clients by using good judgment in carefully reviewing each of the reinsurance markets with which we place business to be certain as possible that they meet our clients' requirements."

the undisputed facts during the relevant time period were:

> "(1) [T]hat each reinsurer was duly licensed and thus deemed solvent by state regulators.
>
> (2) [T]hat these reinsurers were all highly rated by A.M. Best Co., the premier rating service for insurance companies.
>
> (3) [T]hat each of the three companies passed the National Association of Insurance Commissioners (NAIC) Early Warning system - IRIS test, designed to spot potential insolvencies.
>
> (4) [T]hat the entire industry -- regulators, rating services, other insurance companies, auditors and brokers -- believed each of [these] three companies to represent sound security during the 1980-1984 time period."
>
> Our own review of the record confirms the accuracy of this summary.

III.

Blanch argues that Cherokee itself had a duty to analyze the financial strength of its reinsurers; that blanch had never accepted a delegation of this duty; and that because it never assumed the duty, Blanch could not be liable for any failure to exercise due care in carrying it out. For purposes of this opinion, however, we shall assume that, as Cherokee contends, Blanch was under a duty to exercise reasonable care in selecting the reinsurers it recommended to its clients.

Although Cherokee does not contest the general rule that stated in *Higginbotham & Associates v. Greer*, 738 S.W..2d 45, 46 (Ct. App. Tex. 1987), an insurance broker "is not a guarantor of the financial condition or solvency of the company from which [the broker] obtains the insurance." Cherokee contends that there are genuine issues of material fact as to whether Blanch violated its duty of care.[4] Citing *Francis v. United Jersey Bank*, 392 A.2d 1233, 1236 (N.J. Super. 1978), *aff'd*, 407 A.2d 1253 (N.J. Super. Ct. App. Div. 1979), *aff'd*, 432 A.2d 814 (N.J. 1981), for the proposition that "the task of the reinsurance broker is much more complicated and sophisticated than that of the ordinary retail insurance broker," Cherokee insists that "the views and beliefs of Guy Carpenter, Bernard Webb and the available trade press on the subject of security analysis to be performed by the prudent reinsurance intermediary create a

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[4]The filing of Cherokee's motion for summary judgment does not preclude Cherokee from contending that there are issues of fact which preclude the granting of summary judgment to Blanch.

> "The fact that both parties make motions for summary judgment, and each contends in support of his respective motion that no genuine issue of fact exists, does not require the Court to rule that no fact issue exists." *Begnaud v. White*, 170 F.2d 323, 327 (6th Cir. 1948).
>
> *Taft Broadcasting Co., v. United States*, 929 F.2d 240, 248 (6th Cir. 1991), is to the same effect.

material factual dispute."

Nothing that we have seen in the Guy Carpenter document, the Bernard Webb testimony, or the trade press can fairly be said to support the proposition that the analysis performed by Blanch fell short of what other reinsurance brokers are customarily doing in the 1980-84 time period. As the magistrate judge correctly noted, Mr. Heifetz attested "without dispute" that the factors set forth in the Carpenter document were identical or very similar to the information reviewed by Blanch's Market Security Committee. Mr. Webb could not say that Blanch's work was deficient by comparison to what other reinsurance brokers were doing, because he did not know what other brokers were doing. And Cherokee's reference to "the available trade press" seems to be little more than a rhetorical flourish; the record does contain a 1980 article suggesting that reinsurance brokers had a significant role to play in monitoring the financial integrity of reinsurers, but the article is couched in broad generalities nd does not discuss the methods of analysis customarily used.

A report issued in 1990 by the Subcommittee on Oversight and Investigation of the Committee on Energy and Commerce of the United States House of Representatives--a subcommittee chaired by Congressman John Dingell--says that Mission Insurance Company failed in part because of its excessive reliance on reinsurance, poor underwriting, severe underpricing inadequate reserving, accounting gimmicks, and false reporting. The subcommittee claimed to have found several types of fraudulent activity at Mission. And the subcommittee said of Transit that "its levels of management

incompetence, excessive reinsurance, and reckless expansion...equal or exceed those observed at Mission..."

Cherokee points to Dingell Committee report as suggesting that the problems of Mission and Transit were "easily detectable by the insurance and reinsurance communities during 1980 to 1984 time frame." The record of this case contains no significant evidence, however, that anyone in the insurance or reinsurance communities did in fact detect these problems during the time frame relevant here.[5] We conclude that there is no material issue of fact as to whether Blanch failed to comply with customary industry standards when it placed Mutual Fire et al. on its approved list and used them as reinsurers for Cherokee.

While conformity with customary practice is evidence of reasonable care, however, it is not necessarily conclusive evidence. Age Learned Hand observed in *The T.J. Hooper*, 60 F.2d 737, 740 (2d Cir.) , *cert denied*, 287 U.S. 662 (1932), an admiralty case involving ocean-going tugs that as late as 1928 were not equipped with radios to receive storm warnings, "there are

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[5]"The alleged negligence of the defendant [reinsurance broker] must be considered in light of his knowledge at the time the policy was issued, and not at the time of the loss and failure to pay the claim." *Master Plumbers Limited Mutual Liability Company v. Cormany & Bird, Inc.*, 255 N.W.2d 533, 535 (Wis. 1977). Reinsurance brokers, moreover, have no authority to audit the books of reinsurance markets, and can hardly be expected to detect false reporting or other fradulent activity.

precautions so imperative that even their universal disregard will not excuse their omission." *Cf.* Restatement (Second) Torts, §295A. Tennessee, the substantive law of which is controlling here, recognizes this principle. See *Easterly v. Advance Stores Co., Inc.*, 432 F. Supp. 7, 7 (E.E. Tenn. 1976) (marshalling Tennessee cases).

Could a jury, instructed in accordance with Tennessee law, be permitted to find that even though defendant Blanch acted in accordance with practices customary in the industry at the time, Blanch was negligent in failing to perform the type of detailed analysis performed by Mr. Webb some years later? The better answer, we think, is "no."

It is far from clear, for on thing, that use of the type of analysis performed by Mr. Webb was "imperative," to borrow Judge Hand's word, in the sense that the use of radios on ocean-going tugs was imperative. The importance of radios was readily apparent, in Judge Hand's case, and the masters of the vessels involved in that case actually had their own private radios on board, although they were not in working order. The use of radios had not yet become general, but some crews carried them and one carrier equipped all its tugs with the devices. The importance of an analysis such as that advocated by Mr. Webb was far less obvious, in the early 1980s, than the importance of radios was in 1928.

Insofar as some such analysis as Mr. Webb's might be considered to have been imperative, moreover, Blanch had no reason to doubt that it was being performed by state regulators -- armed with investigatory powers not available to private brokers -- and by the A.M. Best Company. Cherokee argues that

the financial strength of a reinsurer's retrocessionaires is obviously important, but the record makes it clear that A.M. Best attempted to analyze this factor. We are not persuaded that it would be open to a fury to find that the entire brokerage industry was negligent in relying on the rating service to evaluate retrocessionaires.

AFFIRMED.

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company,	)	
Plaintiff,	)	
VS.	)	CIVIL ACTION NO.
E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, FRANK S. WILKINSON, General Partner, and PAUL S. MAVROS, General Partner	)	3 90 0581 JUDGE NIXON
Defendants.	)	

NOTICE OF REMOVAL

TO: The Judges of the United States District Court For The Middle District of Tennessee

Defendants, E.W. Blanch Co., E.W. Blanch, Jr., General Partner, Michael W. Cashman, Sr., General Partner, Frank S. Wilkinson, General Partner, and Paul S. Mavros, Limited Partner (erroneously sued as "General Partner"), respectfully show to the

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Court as follows:

1. On June 4, 1990, a Summons and Complaint was filed in the Chancery Court for Davidson County, Tennessee, the case being styled Cherokee Insurance Company, by and through David S. Weed, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company v. E.W. Blanch Co., E.W. Blanch, Jr., General Partner, Michael W. Cashman, Sr., General Partner, Frank S. Wilkinson, General Partner and Paul S. Mavros, General Partner, being Docket No. 90-1743-III. Defendants' agent for service of process, CT Corporation System was served with the Summons and Complaint on June 7, 1990. A copy of the Complaint with attached Summons is attached hereto as Exhibit A. No other proceedings have been had herein.

2. The above-described action is one of which this Court has original jurisdiction under 28 U.S.C. § 1332, in that there is

complete diversity of citizenship between the Plaintiff, a Tennessee corporation with its principal place of business in Tennessee, nd each of the Defendants E.W. Blanch Co., is a Delaware limited partnership with its principal office in Minnesota. Its general partners are all citizens of Minnesota, with the exception of Glifford English, who is a citizen of a state other than Tennessee. Its limited partners are all citizens of a state other than Tennessee. Defendant Mavros is a limited partner and a citizen of a state other than Tennessee The amount in controversy, exclusive of interest and costs, exceeds $50,000. This cause may be removed to this Court by the Defendants pursuant to the provisions of 28 U.S.C. § 1441, in that it is a civil action in which the district courts of the United States have original jurisdiction.

3. Because the Summons and Complaint in this action were served on June 7, 1990,

this Notice has been filed within the time allowed for removal by 28 U.S.C. § 1446(b).

4. Pursuant to H.B. 4807, Title X, § 1016(d), this Notice is accompanied by the requisite $120.00 filing fee.

5. The Clerk and Master for the Chancery Court of Davidson County, Tennessee and counsel for Plaintiff have been provided with a copy of this Notice.

WHEREFORE, Defendants pray the able action now pending in the Chancery Court for Davidson County, Tennessee be removed therefrom to this Court.

This 29th day of June, 1990.

Jay S. Bowen (#2649)
Nancy-Ann E. Min (#10811)
BASS, BERRY & SIMS
2700 First American Ctr.
Nashville, TN 37238
Telephone: (615) 742-6211

Attorneys for Defendants

OF COUNSEL:

Daniel P. O'Keefe
Juan C. Basombrio
DORSEY & WHITNEY
2200 First Bank Place East
Minneapolis, MN 55402
(612) 340-2600

CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing has been served upon William B. Hubbard, Esq., and Brenner B. Lackey, Esq., Littleton, Weed, & Hubbard, 424 Church Street, Suite 2006, Nashville, Tennessee 37219, this 29 day of June, 1990.

_____

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company,	)	
Plaintiff,	)	
VS.	)	NO: 90-1743-III
E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, FRANK S. WILKINSON, General Partner, and PAUL S. MAVROS, General Partner	)	JURY DEMAND
Defendants.	)	

COMPLAINT

Introduction

In an attempt to spread the risks from insurance policies it had written, Plaintiff, Cherokee Insurance Company, ceded or transferred certain of these insurance risks to various reinsurers. Defendant, E.W. Blanch Co., served as Plaintiff's intermediary, evaluating the reinsurance

needs of the Plaintiff; gathering information about the Plaintiff to present to potential reinsurers; financially evaluating potential reinsurers; and, ultimately placing Plaintiff's business with reinsurers. Defendant received commissions or brokerage fees from the premiums ceded by the Plaintiff's business with reinsurers. Defendant received commissions or brokerage fees from the premiums ceded by the plaintiff to the reinsurers. Defendant failed to satisfactorily perform its contract with Plaintiff in that it placed Plaintiff's business with financially unsound reinsurers, directly resulting in approximately $2,495,340.00 in ascertainable damages as of December, 1989, to the Plaintiff. Plaintiff alleges negligence in the performance of Defendant's duties and breach of contract.

PARTIES

1. Plaintiff, Cherokee Insurance Company ("Cherokee") is an insurance company

incorporated and authorized to do business under the laws of the State of Tennessee. Cherokee was placed in rehabilitation on July 17, 1984, by the Tennessee Commissioner of Commerce and Insurance with the authorization and approval of the Chancery Court for Davidson County, Tennessee. The rehabilitation proceeding is currently pending under the caption Elaine A. McReynolds, Commissioner of Commerce and Insurance v. Cherokee Insurance Company. NO. 84-1460-III. David S. Weed is Special Deputy Commissioner of Commerce and Insurance for the rehabilitation of Cherokee Insurance Company.

2. E.W. Blanch Co., ("Blanch") is a professional, multi-faceted international reinsurance organization which was founded in 1957. It is a limited partnership, organized under the laws of the State of Delaware, licensed in the State of New York, authorized to do business in the State of Minnesota and

doing business in all states. It's central offices are located at 3500 W. 80th Street, Minneapolis, Minnesota 55431, and it maintains branch offices in New York, New York; Chicago, Illinois; San Francisco, California; Hartford, Connecticut; and Copenhagen, Denmark.

3. E.W. Blanch, Jr., Michael W. Cashman, Sr., Frank S. Wilkinson, and Paul S. Mavros are all general partners in E.W. Blanch Co.

PERSONAL JURISDICTION

4. During the period from 1979 to 1985, Billy L. Atkin, CPCU, Senior Vice President and Secretary of Cherokee and, John Ryman, CPCU, President of Cherokee, were induced by Blanch to continue to utilize Blanch as their reinsurance intermediary to manage their reinsurance needs and to place their insurance risks with reinsurers.

5. Both Edward W. Frye, Jr., CPCU,

Vice President of Blanch, and Steven M. Lonergan, CPCU, Secretary of Blanch made numerous trips to Tennessee. Each year from 1980 until 1985, Ed Frye and/or Steve Lonergan would come to Tennessee at year and to solicit Cherokee's business and determine Cherokee's reinsurance needs for the upcoming year. Furthermore, throughout these years Ed Frye, Steve Lonergan and/or some other representative of Blanch would communicate with Cherokee in Tennessee, either in person, telephonically or by mail, to check up on Cherokee and update Cherokee on its reinsurance placement.

6. Blanch purposefully availed itself of the laws of the State of Tennessee, by soliciting and conducting business in Tennessee in an effort to economically prosper. Therefore, Tennessee may rightfully exercise personal jurisdiction over Blanch.

BREACH OF CONTRACT AND NEGLIGENT PERFORMANCE OF CONTRACT

COUNT I

7. Reinsurance arrangements spread risks among a number of insurers. In the typical arrangement, one company will transfer or "cede" some portion of an insurance risk to one or more reinsurers. Each transfer of risk is considered a contract assignment rather than a novation, as the ceding company is responsible fore the entire payment of the liabilities to the policyholders even if it had ceded most of the premium and risk away. If its reinsurer defaults on its payments, the ceding company is liable to pay losses even though it had ceded the premium payments to the reinsurers.

8. In the usual and customary intermediary/ceding company relationship the intermediary performs several contractual duties. The intermediary solicits business from the ceding company and then places the

business with reinsurers. The intermediary evaluates the reinsurance needs of the ceding company to present to potential reinsurers. It then prepares a placement slip summarizing the proposed reinsurance treaty and attaches pertinent statistics.

9. The intermediary evaluates potential reinsurers and consultants with the ceding company on the security of the placement. Often, it drafts the language of the treaties and seeks the concurrence of the parties. Normally, the treaties are written and/or renewed on a yearly basis to cover the direct insurance written during the year. The reinsurers for casualty risks receive a positive flow of premiums soon after the treaties are executed; however, the flow of funds reverses when the losses begin to be experienced. The losses may not be experienced for several years after any given treaty is written.

10. After placing the reinsurance, the

intermediary receives reports from the ceding company and reports the data to the reinsurances. These accounting records typically contain data relating to the premiums and the losses. The intermediary transmits premiums to the reinsurers from the ceding company and payments for losses from the reinsurers to the ceding company. Generally, the intermediary's fee is calculated as a percentage of the net premium ceded and such compensation is deducted from the premiums by the intermediary before forwarding the premiums to the reinsurers.

11. The duty of the intermediary to use due and reasonable care in the performance of its professional services arises from the contractual nature of the usual and customary intermediary/ceding company relationship. Although, as is normally the case, no document setting forth the totality of the terms of the agreement between Blanch and Cherokee existed, all of

the essential elements of a contract were present. Each year blanch offered its professional services to Cherokee and each year Cherokee accepted the use of such professional services.

12. Blanch served as Cherokee's predominate reinsurance intermediary from the late 1960's until 1985. Blanch received a commission or brokerage fee based upon the volume of business placed with reinsurers. Blanch promised to evaluate Cherokee's reinsurance needs, to gather information about Cherokee to present to potential reinsurers, to financially evaluate potential reinsurers and ultimately to place reinsurers on Cherokee's treaties. In return, Cherokee promised to utilize Blanch's services and to rely on Blanch's expertise. The foregoing mutual promises between Cherokee and Blanch constituted adequate consideration for a valid and enforceable contractual agreement.

13. Blanch continued to serve as

Cherokee's reinsurance intermediary from 1980 to 1985. Extensive correspondence passed between the two parties. At the end of each year, Blanch and Cherokee would meed and discuss Cherokee, generally, and its reinsurance needs specifically. Subsequent to each year end meeting, usually in January, Cherokee would receive a letter from blanch summarizing the meeting and listing the upcoming year's reinsurance subscription agreements. The contractual arrangement followed this pattern throughout these years.

14. Cherokee was a small insurance company. Cherokee did not have the staff and capability of managing its reinsurance. Cherokee relied upon Blanch to advise it on the placement of its reinsurance. On occasion, Blanch even advised Cherokee to cease writing particular direct insurance because Blanch considered the risks excessive. Blanch exclusively managed Cherokee's reinsurance treaties for its

direct policies for a number of years.

15. Blanch successfully managed Cherokee's reinsurance treaties for a number of years. Cherokee learned to trust Blanch and rely upon it for Cherokee's reinsurance needs. Blanch failed to exercise reasonable skill, diligence and due care in performing its duties under the contract with Cherokee, including its duty to financially analyze the reinsurance companies placed on Cherokee's treaties from 1980 through 1984. An intermediary with the reinsurance companies being placed on Cherokee's treaties were financially unsound. At a minimum, Blanch failed to warn Cherokee of any apprehensions it was experiencing or reasonably should have experienced regarding the financial stability of the various reinsurers. As a result of Blanch's negligent placement of Cherokee's business, Cherokee, the ceding company, as of December 1987 has suffered damages approximating $2,495,340.00. The reinsurance

companies presently insolvent or under some kind of supervision due to financial instability are Mutual Fire Marine and Inland, Northwestern National, Universal Reinsurance, Transit Casualty Company and the Mission Insurance Company. As of December 1989 the estimated breakdown of losses from ceding reinsurance risks to these companies is:

1. Mutual Fire Marine and Inland - 397,288.00
2. Northwestern National - $1,639.00
3. Universal Reinsurance - $1,259,376.00
4. Transit Casualty - $529,750.00
5. Mission - $307,287.00

TOTAL - $2,495,340.00

These damages to Cherokee are largely attributable to the high proportion of Cherokee's main working cover or treaty - "The Combined Property and Casualty Excess of Loss Reinsurance Treaty" - which Blanch placed with these insolvent or financially unstable reinsurers. During 1980-1984, the breakdown of percentages was as follows:

1. In 1980, Blanch placed 30% of Cherokee's main working treaty with Universal Reinsurance.

2. In 1981, Blanched placed 50% of Cherokee's main working treaty with Universal Reinsurance.

3. In 1982, Blanch placed 50% of Cherokee's main working treaty with Universal Reinsurance and 25% with Mission Insurance Company; hence, 75% of Cherokee's main working treaty was placed with insolvent or financially unstable reinsurers.

4. IN 1983, Blanch placed 50% of Cherokee's main working treaty with Universal Reinsurance and 25% with Mission Insurance Company; hence 75% of Cherokee's main working treaty was placed with insolvent or financially unstable reinsurers.

5. In 1984, Blanch placed 50% of Cherokee's main working treaty with Northwestern National, and 25% with Mission Insurance Company; hence, 75% of Cherokee's main working treaty was placed with insolvent or financially unstable reinsurers.

16. Blanch failed to exercise reasonable skill, diligence and due care in performing its contract with Cherokee by choosing not to diversify Cherokee's

business. Blanch negligently concentrated Cherokee's insurance risks with one or a few reinsurers. At a minimum, Blanch should have informed Cherokee of the risks accompanying concentration of its business with one or a few reinsurers. From such failure to diversify, or to warn ,it can be inferred that Blanch's allegiance law with the reinsurers instead of where it belonged, with Cherokee.

17. Blanch failed to exercise reasonable skill, diligence and due care in performing its contract with Cherokee by placing reinsurance companies, not recognized as professional reinsurance companies, on Cherokee's treaties. Transit Casualty Company began doing business in 1945 as a transportation insurance company exclusively. Transit did not even enter the reinsurance business until 1978. Similarly, Mutual Fire Marine and Inland incorporated in 1902 as a transportation insurance company exclusively

and did not enter the reinsurance business until the late 1970's or early 1980's. The Mission Insurance Company began doing business in 1948 as Mission Indemnity writing predominately worker's compensation. In 1980, Mission entered the reinsurance business but, as of 1983, Mission was still writing predominately worker's compensation. All of the foregoing companies were newcomers to the reinsurance business when Blanch placed them on Cherokee's treaties. By placing companies that were inexperienced in the reinsurance field on Cherokee's treaties, Blanch unnecessarily gambled with Cherokee's reinsurance with companies that did not have a proven record.

18. In 1980, Armco Insurance Group, Inc. an intermediate holding company of Armco Steel Company, purchased both Northwestern National and its subsidiary, Universal Reinsurance. At the time of the purchase, Armco Insurance Group was financially

unsound. Armco hoped Northwestern would provide it with the financial strength and management which it needed. Northwestern National's and Universal Reinsurance's association with Armco Insurance Group made them financially unstable Northwestern National was a standard lines insurance company that participated in reinsurance business through its subsidiary Universal Reinsurance, until Universal Reinsurance ceased writing business did Northwestern National assume some of Universal Reinsurance's reinsurance risks and became actively involved in the reinsurance business. Blanch negligently concentrated Cherokee's insurance risks with Northwestern National and Universal Reinsurance at a time when the strength of both was questionable given their recently having been purchased by a financially troubled group. By placing companies that were inexperienced in the reinsurance field on Cherokee's treaties,

Blanch unnecessarily gambled with Cherokee's reinsurance with companies that did not have a proven record. Because Blanch unnecessarily gambled with Cherokee's reinsurance, plaintiff assumes Blanch received an additional economic benefit from these placements.

19. Blanch was required to exercise the reasonable care and competence ordinarily and customarily required of reinsurance intermediaries in the same or similar circumstances or to exercise reasonable prudence under the circumstances, whichever of the two standards being more exacting, in the performance of its contractual obligation to provide the professional services of placing Cherokee's business with reinsurer. If a negligent standard existed in the industry at the time, Blanch should have done what was reasonably prudent and should not have been permitted to follow a standard which was the result of an industry or trade

adopting careless methods in an effort to save time and money at the expense of Cherokee. The failure of Blanch to adhere to the accepted standard of care in the industry, if a prudent on existed at the time, or if not, Blanch's failure to adhere to reasonable prudence under the circumstances, caused the great economic loss suffered and continually being suffered by Cherokee. Such damages suffered because of Blanch's failure to exercise reasonable prudence in the performance of its contractual obligations to Cherokee, were reasonably foreseeable.

COUNT II

20. Plaintiff, Cherokee, adopts by reference the allegations in paragraphs 1 through 18 as if there were repeated herein.

21. Blanch represented to Cherokee that because of Blanch's size, internal organization and available research

facilities, Cherokee would benefit substantially through use of Blanch's professional services. Such representations and assurance were both oral and written as well as implicit in Blanch's promotional materials. Further blanch assured Cherokee that, if Cherokee relied on Blanch as its reinsurance intermediary, Blanch would supervise and manage Cherokee's reinsurance needs in such a way as to spread Cherokee's insurance risks effectively over the long term. The implicit inducements by Blanch through its reputation and size, as well as its many explicit representations created contractual terms and duties that might not have existed were Cherokee not the size and naive participant in the reinsurance realm it was. Easily inferred form the contractual arrangement between Cherokee and Blanch was Blanch's duty to financially analyze the reinsurers it would place on Cherokee's treaties and to do so in a reasonably prudent

manner. Blanch breached the implied terms of its contractual arrangement with Cherokee by negligently and unsatisfactorily managing Cherokee's insurance risks through failure to place such risks with reinsurers offering ling term financial stability in accord with Cherokee's objectives. Furthermore, Blanch breached the implied condition of its contractual arrangement with Cherokee that it would carefully monitor the financial stability of the companies placed on Cherokee's treaties and advise Cherokee as to any apprehensions it had about any of these companies.

22. The above described conditions and terms of contracting were material and Cherokee therefore reasonably relied on them when contracting with Blanch. Blanch through continuous correspondence as well as oral assurances, repeatedly represented to Cherokee that Blanch was capable of rendering professional reinsurance intermediary advice

and management. Blanch was aware of Cherokee's limited knowledge about the reinsurance market and general unfamiliarity with the financial status of the various reinsurers.

23. Blanch held itself out as an expert in the field of reinsurance placement thereby creating terms in the contract with Cherokee which is subsequently breached. Cherokee placed complete trust and gave complete discretion to Blanch, despite the formality of Cherokee's final review, to Blanch. Blanch administered and managed Cherokee's reinsurance needs in a manner that was unprofessional, unreasonable and in direct contravention and breach of contract.

24. As a direct and proximate result of Blanch's breach of the foregoing material terms and conditions of its contract with Cherokee, Cherokee had suffered, as of December, 1989, approximately $2,495,340.00 in ascertainable damages.

COUNT III

25. Plaintiff Cherokee, adopts by reference the allegations in paragraphs 1-18 and 19-23 as if there were repeated herein.

26. Blanch breached the terms of the mutual understanding between Blanch and Cherokee that blanch was not to place any reinsurers on Cherokee's treaties unless these reinsurers met certain minimum criteria. Such minimum criteria were designed to insure that only properly managed and financially sound reinsurers would share Cherokee's insurance risks. Blanch's placement of reinsurers on Cherokee's treaties which were not capable of meting the mutually agreed upon minimum criteria clearly resulted in poorly managed and financially unsound reinsurers being placed on Cherokee's treaties. Consequently, Cherokee had suffered, as of December 1989, approximately $2,495,340.00 in ascertainable damages.

PREMISES CONSIDERED, Plaintiff Prays:

1. For a judgment against Blanch for Cherokee's damages.

2. For costs.

3. For such other and further relief to which Cherokee is entitled.

TORT

COUNT IV

27. Plaintiff, Cherokee adopts by reference the allegations in paragraphs 1-19.

28. Blanch owed Cherokee a duty to exercise reasonable prudence, diligence and due care in the placement of Cherokee's insurance risks with reinsurers. Encompassed with such duty was not only the obligation of Blanch to reasonably attempt to place Cherokee's business with solvent and financially sound reinsurers but also the obligation of Blanch to monitor the financial stability of the reinsurers and to warn Cherokee of any financial weaknesses perceived in such reinsurers. Blanch breached its duty to exercise reasonable

prudence, diligence and due care and failed to met its obligations as encompassed therein.

29. Blanch's breach of the duty owed Cherokee to exercise reasonable prudence, diligence and due care in the placement of Cherokee's business had proximately caused, as of December, 1989, $2,495,340.00 in ascertainable damages to Cherokee.

PREMISES CONSIDERED, Plaintiff Prays:

1. For a judgment against Blanch for Cherokee's damages.

2. For a judgment against Blanch for punitive damages according to proof.

3. For costs.

4. For such other and further relief to which Cherokee is entitled.

Respectfully submitted

Littleton, Weed & Hubbard

By: _____
William B. Hubbard (2770)

_____
Brenner B. Lackey (13302)
424 Church St., Ste. 2006
Nashville, TN 37219
(615) 255-1773

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company,	)	
Plaintiff,	)	
VS.	)	CIVIL ACTION
E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, FRANK S. WILKINSON, General Partner, and PAUL S. MAVROS, General Partner	)	NO. 3 90 0581 Judge JUDGE ECHOLS
Defendants.	)	

ORDER

Presently pending before this Court is the Magistrate Judge's Report and Recommendation ("R&R) to which the Plaintiff has filed Objections, and the Defendants have responded. (Docket Entry NO. 106). This matter was initially referred to the Magistrate Judge for his consideration and

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recommendation as to any pre-trial matters pursuant to 28 U.S.C. § 636(b)(1)(A) and (B) and L.R.M.P. 302 and 303. Initially, both parties filed Cross-Motions for Summary Judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. IN his first R&R, the Magistrate Judge recommended that this Court grant the Defendants' Motion for Summary Judgment as to three of the Plaintiff's claims, deny the Defendants' Motion as to the Plaintiff's two remaining claims, and deny the Plaintiff's Motion for Summary Judgment in its entirety. (Docket Entry No.66). Before this considered the initial R&R, the parties requested that the Magistrate Judge reconsider his previous ruling in light of additional evidence which the parties wished to present. The Magistrate Judge granted the Motion to Reconsider, and, upon reconsideration, issued a second R&R, which is presently before this Court. (Docket Entry NO. 106). IN his second

R&R, the Magistrate Judge has recommended that the Defendants' Motion for Summary Judgment be granted as to all of the Plaintiff's remaining claims[1], and that this action be dismissed.

Pursuant to Rule 72(b) of the Federal Rules of Civil Procedure, this Court must review the Magistrate Judge's R&R de novo. This Court has thoroughly reviewed the Magistrate Judge's Report and Recommendation, all of the parties' Motions, that Plaintiff's Objection thereto, and the Defendants' Response thereto. After full consideration of the entire record in this case, the Court is of the opinion that the Magistrate Judge's final Report and Recommendation, which grants the Defendants'

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[1]Subsequent to the entry of the first R&R, the Plaintiff voluntarily dismissed its claims against Blanch regarding any reinsurance placement with Universal Reinsurance Corporation and Northwestern National Insurance Company.

Motion for Summary Judgment dismissal of all of the Plaintiff's remaining claims, is well-taken and should be adopted. As such, the Magistrate Judge's Report and Recommendation is hereby ADOPTED in its entirety, the Defendants' Motion for Summary Judgment dismissal of the Plaintiff's remaining claims is hereby

GRANTED, and this action is accordingly

DISMISSED.

ROBERT L. ECHOLS
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company

Plaintiff,

Court File No. 3-90-0581

vs.

JUDGE NIXON

JOINT ANSWER

E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, and PAUL S. MAVROS, General Partner

---

Defendants E.W. Blanch Co., ("Blanch"), E.W. Blanch, Jr., Michael W. Cashman, Sr., Frank S. Wilkinson, and Paul S. Mavros, for their Joint Answer to the Complaint in the above-captioned action, state and allege as follows:

FIRST DEFENSE

1. Defendants object to the form and substance of the Complaint as constituting a narrative in violation of Fed. R. Civ. P. 8(e)(1), which requires averments in pleadings to be "simple, concise and direct."

2. Defendants deny each and every allegation in the Complaint, unless expressly admitted, qualified or otherwise answered.

3. With respect to the allegations in the Paragraph of the Complaint labelled "Introduction," defendants admit that Blanch functioned as the intermediary on certain reinsurance arrangements involving Cherokee Insurance Company ("Cherokee"); admit that Blanch transmitted information regarding Cherokee to potential reinsurers; admit that Blanch received standard brokerage fees from certain reinsurers; and deny the remaining allegations.

4. With respect to the allegations in Paragraph 1 of the Complaint, defendants

admit that Cherokee is a corporation, incorporated in Tennessee on July 20, 1946; admit that Cherokee does business in Tennessee and in other states; admit that Cherokee is in rehabilitation; and state that defendants are without knowledge and information sufficient to form a belief as to the truth of the remaining allegations.

5. With respect to the allegations in Paragraph 2 of he Complaint, defendants admit that Blanch is a reinsurance intermediary; admit that Blanch is a limited partnership organized under the laws of Delaware, authorized to do business in Minnesota, doing business in Minnesota and other states, with its headquarters located at 3500 W. 80th Street, Minneapolis, Minnesota 55431, and having branch offices in New York, Chicago, San Francisco, Hartford, and Copenhagen; deny the characterization of blanch as "a professional multi-faceted reinsurance organization," on the grounds that the term

is vague and ambiguous, and to the extent that Cherokee attempts, by the use of such categorization, to abscribe to Blanch any knowledge or standard of conduct higher than that of a reinsurance intermediary at the time the subject reinsurance was placed; and deny the remaining allegations.

6. Defendants admit the allegations in Paragraph 3 of the Complaint, except that defendant Paul S. Mavros denies that he is a general partner of Blanch.

7. With respect to the allegations in Paragraphs 4 through 6 of the Complaint, defendants admit that Tennessee has personal jurisdiction over Blanch; admit that on occasion Blanch personnel made trips, telephone calls and sent correspondence to Tennessee pursuant to Blanch's business as a reinsurance broker; deny Cherokee's characterization of Blanch's activities in Tennessee; and deny the remaining allegations.

8. With respect to the allegations in Paragraph 7 through 9 of the Complaint, defendants admit that Blanch functioned as the intermediary on certain reinsurance arrangements involving Cherokee; deny Cherokee's characterization of the reinsurance business on the grounds that the characterization is vague, inaccurate, oversimplied, and misrepresents and diminishes the uniqueness ,scope and complexity of each individual reinsurance arrangement; and deny the remaining allegations.

9. Defendants generally admit the allegations in Paragraph 10 of the Complaint.

10. With respect to the allegations in Paragraph 11 of the Complaint, defendants admit that there is not document or writing constituting an agreement between Blanch and Cherokee respecting the subject matter of this action, and deny the remaining allegations.

11. With respect to the allegations in Paragraph 12 of the Complaint, defendants admit that Blanch functioned as the intermediary on certain reinsurance arrangements involving Cherokee; admit that Blanch received standard brokerage fees from certain reinsurers; admit that Blanch transmitted information about Cherokee to potential reinsurers; admit that Blanch made reinsurance proposals as requested, instructed and agreed to by Cherokee; state that defendants are without knowledge and information sufficient to form a belief as to the truth of the allegation that Blanch was the "predominate" reinsurance intermediary on reinsurance arrangements involving Cherokee' deny that Blanch was "Cherokee's intermediary," and deny the remaining allegations.

12. With respect to the allegations in Paragraph 13 of the Complaint, defendants admit that Blanch functioned as the

intermediary on certain reinsurance arrangements involving Cherokee; generally admit that Blanch would meet periodically with Cherokee and receive requests and instructions from Cherokee regarding its reinsurance needs; generally admit that Blanch would keep Cherokee informed of its activities regarding the requests and instructions received from Cherokee; deny that Blanch and Cherokee entered into any "contractual arrangement" regarding the subject matter of this action; deny Cherokee's characterization of its correspondence with Blanch as "extensive" on the grounds that the characterization is vague and ambiguous; and deny the remaining allegations.

13. Defendants deny the allegations in Paragraph 14 of the Complaint.

14. With respect to the allegations in Paragraph 15 of the Complaint, defendants admit that Blanch is a competent reinsurance

intermediary; admit that 30% of the participation on Cherokee's Combined Property and Casualty Excess of Loss Treaty was placed with Universal Reinsurance in 1980; admit that 50% of the participation on Cherokee's Combined Property and Casualty Excess of Loss Treaty was placed with Universal Reinsurance in 1981; admit that 50% of the participation on Cherokee's Combined Property and Casualty Excess of Loss Treaty was placed with Universal Reinsurance in 1982; admit that 25% of the participation on Cherokee's Combined Property and Casualty Excess of Loss Treaty was placed with Mission Insurance Company in 1982; admit that 50% of the participation on Cherokee's Combined Property and Casualty Excess of Loss Treaty was placed with Universal Reinsurance in 1983; admit that 25% of the participation on Cherokee's Combined Property and Casualty Excess of Loss Treaty was placed with Mission Insurance Company in 1983; admit that 50% of the

participation on Cherokee's Combined Property and Casualty Excess of Loss Treaty was placed with Northwestern National in 1984; admit that 25% of the participation on Cherokee's Combined Property and Casualty Excess of Loss Treaty was placed with Mission Insurance Company in 1984; deny that Blanch "managed" Cherokee's reinsurance programs; and deny the remaining allegations.

15. Defendants deny the allegations in Paragraph 16 through 19 of the Complaint.

16. With respect to the allegations Paragraph 20 of the Complaint, defendants incorporate by reference to their responses in Paragraphs 1 thorough 15 of this Joint Answer.

17. Defendants deny the allegations in Paragraph 21 though 24 of the Complaint.

18. With respect to the allegations Paragraph 25 of the Complaint, defendants incorporate by reference to their responses in Paragraphs 1 thorough 15 of this Joint

Answer.

19. Defendants deny the allegations in Paragraph 26 of the Complaint.

20. With respect to the allegations Paragraph 27 of the Complaint, defendants incorporate by reference their responses in Paragraphs 1 through 15 of this Joint Answer.

21. Defendants deny the allegations in Paragraphs 28 and 29 of the Complaint.

22. Defendants state that Cherokee has not pleaded facts with sufficient particularity to substantiate its prayer for punitive damages.

23. Defendants deny Cherokee's entitlement to any and all relief prayed for the Complaint.

SECOND DEFENSE

LACK OF PERSONAL JURISDICTION

24. This Court lacks personal jurisdiction over the following defendants: E.W. Blanch, Jr., Michael W. Cashman, Sr., Frank S. Wilkinson, and Paul S. Mavros.

THIRD DEFENSE

STATUTE OF LIMITATIONS

25. Cherokee's claims are barred by the applicable statutes of limitations.

FOURTH DEFENSE

LACHES

26. Cherokee lacked diligence and neglected to assert its claims seasonably. Cherokee's conduct constitutes an unreasonable delay, which causes unjust prejudice to Blanch, and operates in equity to bar Cherokee's claims under the doctrine of laches.

FIFTH DEFENSE

STATUTE OF FRAUDS

27. Cherokee's claims are barred by the Statute of Frauds.

SIXTH DEFENSE

FAILURE TO STATE A CLAIM

UPON WHICH RELIEF CAN BE GRANTED

28. The Complaint fails to state a claim upon which relief can be granted.

SEVENTH DEFENSE

RATIFICATION/CONSENT

29. Cherokee's claims are barred by Cherokee's ratification of and/or consent to the alleged conduct, acts, omissions and events that are the subject of this action.

EIGHTH DEFENSE

EQUITABLE ESTOPPEL

30. Cherokee's claims are barred under the doctrine of equitable estoppel.

NINTH DEFENSE

CONTRIBUTORY NEGLIGENCE

31. Cherokee's claims are barred under the doctrine of contributory negligence.

TENTH DEFENSE

ASSUMPTION OF THE RISK

32. Cherokee's claims are barred under the doctrine of assumption of the risk.

ELEVENTH DEFENSE

WAIVER

33. Cherokee's clams are barred under the doctrine of waiver.

WHEREFORE defendants ask the Court pray for:

A. Judgment on all counts against the plaintiff and in favor of the defendants'

B. an Order awarding the defendants their costs and disbursements herein, including reasonable attorneys' fees; and

C. any such other relief as the Court deems just and equitable

Dated: _____, 1990.

RESPECTFULLY SUBMITTED,

DORSEY & WHITNEY
Daniel P. O'Keefe
Juan C. Basombrio
2200 First Bank Place East
Minneapolis, MN 55402
Telephone: (612) 340-2600

LOCAL COUNSEL:

By_____
Jay S. Bowen
Nancy Ann Min
BASS, BERRY & SIMS
2700 First Am. Ctr.
Nashville, TN 37238
Telephone: 742-6200

ATTORNEYS FOR DEFENDANTS

CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing has been served upon William B. Hubbard, Esq., and Brenner B. Lackey, Esq. Littleton, Weed & Hubbard, 424 Church Street, Suited 2806, Nashville, Tennessee 37219, this _____ day of July, 1990.

_____

3/7/90

REDACTED

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

GEORGE F. GRODE, Insurance Commissioner of the Commonwealth of Pennsylvania, Plaintiff	) No.3483 C.D. 1986
v.	) (Proceedings for
THE MUTUAL FIRE, MARINE & INLAND INSURANCE COMPANY, Defendant	) Rehabilitation Of A Domestic Insurer)

PLAN OF REHABILITATION
Dated January 31, 1989
as Modified by Order Dated
January 23, 1990

This Modified Plan of Rehabilitation is proposed pursuant to 40 P.S. Section 221.16(d) by Constance B. Foster, Insurance Commissioner of the Commonwealth of Pennsylvania, as Rehabilitator of the Mutual Fire, Marine & Inland Insurance Company (the "Plan"). The Plan supersedes

A-6

all previous plans of rehabilitation proposed and/or confirmed, supersedes any prior inconsistent Orders or agreements and governs the payment and satisfaction of all rights and Claims against the assets of Mutual Fire of all persons interested in the Rehabilitation of Mutual Fire. Such parties shall have no rights or Claims against the assets of Mutual Fire other than as are provided by the Plan.

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SECTION I.
Definitions

For purposes of this Plan, and unless the context otherwise requires, the terms set forth below shall have the following meanings:

1. Adjusted Claim. A Loss Claim against Mutual Fire that has been approved by the Rehabilitator or the Court, or through the claim resolution procedures set forth in Section VII.

2. Administrative Claims. The costs and expenses of administration, including but not limited to the following: the actual and necessary costs of preserving or recovering the assets of Mutual Fire; compensation for all services rendered in the Rehabilitation; any necessary filing fees; the fees and mileage payable to witnesses; reasonable attorneys' fees, including provisions of any employment agreements entered into by the Rehabilitator.

3. Case Reserves. The aggregate estimated amounts of Claims reported but not adjusted in accordance with Section VII.

4. Cedent. An entity reinsured under a contract or agreement of Reissuance written by Mutual Fire.

5. Claim. The assertion of a right to payment from Mutual Fire, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, indisputed, legal, equitable, secured or unsecured; or, the right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured or unsecured.

6. Claimant. A person or entity making a Claim.

7. Court. The Commonwealth Court of Pennsylvania.

8. Creditor. The holder of a Claim.

9. Deficiency Claim. The amount of the Claim of a Secured Creditor less the value of said Claimant's interest in Mutual Fire's interest in property securing said Claim.

10. Distribution Date. A date on which interim partial payments are made under the Proportional Payments Method with respect to Adjusted Claims.

11. Due and Owing. Reinsurance recoverable on paid Losses, paid Loss Adjustment Expenses, Claim settlements and reimbursement agreements.

12. Effective Date. The date on which this Plan is approved by final Order, which order is not subject to a motion for reconsideration or an appeal and for which the time to seek reconsideration or file an appeal has expired.

13. Estimation Margin. A Claims category established under the Proportional Payments Method representing the estimated potential for error in ascertaining

reserves due to adverse loss development and other factors, relevant to estimates of Case Reserves and IBNR.

14. Guaranty Association. A state insurance Guaranty Association or security fund that is obligated by law to pay certain covered claims arising under Mutual Fire's Insurance policies pursuant to applicable state law.

15. Incurred But not Reported ("IBNR") Losses. Losses that have occurred but have not been reported, and development of reported Claims, the estimated amount of which has been statistically determined by independent actuaries based on data regarding the history of Mutual Fire's losses and insurance industry data.

16. Loss(es), Loss claim(s). A Claim other than a Claim of a Cedent or Surety Bond Lender arising out of an event covered by a policy of insurance issued by

Mutual Fire.

17.

Loss Adjustment Expenses. Attorneys fees, claims to adjustment of Claims covered by policies of insurance issued by Mutual Fire and incurred in connection with the adjustment of Losses occurring thereunder.

18. Mutual Fire. The Mutual Fire, Marine & Inland Insurance Company and its estate.

19. Petition Date. The date of the filing of the Petition for Rehabilitation of Mutual Fire, December 4, 1986.

20. Plan. This Modified Plan of Rehabilitation, all exhibits thereto, and any modifications or amendments thereof.

21. Policyholder. An insured under a policy of insurance issued by Mutual Fire, that afforded coverage during the period or periods that such policy was or is in effect, excluding Surety Bond Lenders, Cedents and Reinsurers.

22. Proportional Payments Method. The method by which Policyholder Loss Claims will be paid or reserved, in part, from time to time, under Section VI of the Plan.

23. Record Date. The date by which Policyholder Loss Claims must be adjusted, as shown by Mutual Fire's records, to qualify for interim partial payments under the Proportional Payments Method on the next Distribution Date.

24. Rehabilitator. Constance B. Foster, Insurance Commissioner of the Commonwealth of Pennsylvania, in her capacity as Rehabilitator of The Mutual Fire, Marine & Inland Insurance Company, and any of her successors and/or Deputies.

25. Reinsurance. A financial obligation under a contract to assume all or part of a risk or risks insured or reinsured by any insurer or Reinsurer. For purposes of this Plan, reinsurance shall include Retrocession.

26. Reinsurer. An entity obligated under a contract of Reinsurance. For purposes of this Plan, Reinsurer shall include Retrocessionaire.

27. Retrocession. The reassigning or ceding by a

Reinsurer to another insurance company of all or part of the risks assumed.

28. Retrocessionaire. The assuming party to a Retrocession.

29. Secured Cedent. A Cedent that is the beneficiary of a letter of credit or trust securing Mutual Fire's Reinsurance obligation or a part of it to that Cedent.

30. Secured Claim. A Claim of a Creditor against Mutual Fire secured by a lien on property, a letter of credit or a trust fund in which Mutual Fire has an interest but only to the extent of the interest of Mutual Fire in said property after deduction of the amount of all prior liens.

31. Secured Creditor. Any Creditor that holds a Secured Claim.

32. Surety Bond. A financial guaranty contract or performance bond contract issued by Mutual Fire to secure repayment of loans made to finance investment

in a real estate limited partnership, an oil and gas limited partnership, or other investment program or guarantying performance.

33. Surety Bond Lender. A Claimant that asserts a Claim under a Surety Bond.

34. Third Party Loss Claim. A Claim under a Mutual Fire liability policy asserted by a Claimant other than a Policyholder.

35. Unsecured Claim. Any Claim that is not a Secured Claim or a cost of administration Claim.

36. Unsecured Creditor. The holder of an Unsecured Claim.

SECTION II.
CLASSIFICATION AND TREATMENT OF CLAIMS

A. Class 1: Secured Claims

Each Secured Claim shall be paid to the extent of the value of the collateral which secures said Claim or by the release to the Secured Creditor of collateral equal to the amount of such Secured Claim. Any collateral held by a Secured Creditor in excess of the amount to which said Secured Creditor is entitled pursuant to this Plan shall be turned over to the Rehabilitator. Deficiency claims shall be classified and treated as Unsecured Claims under Class 6.

1. Secured Cedents. A Cedent whose Claim is secured by a letter of credit or a trust shall be permitted to draw upon the letter of credit or trust funds only in such amounts as are due, without acceleration, from Mutual Fire for paid Losses and paid Loss Adjustment Expenses reported to Mutual Fire of such Cedent as approved by the Rehabilitator or the Court. Deficiency Claims of such Cedents shall be classified and treated as unsecured Claims under Class 6. Investment earnings from Mutual Fire assets which are collateral that

secures letters of credit or trust obligations to a Cedent or which are otherwise held in trust shall continue to accrue to the benefit of Mutual Fire's estate.

2. Financial Institutions. Financial institutions that hold assets of Mutual Fire in trust or as collateral to secure obligations under letters of credit shall, as approved by the Rehabilitator or the Court, liquidate collateral only in amounts necessary to cover proper draws against such trust funds and letters of credit, or as necessary to discharge obligations of a trustee or Secured Creditor. Deficiency Claims of financial institutions shall be classified and treated as Unsecured Claims under Class 6. Investment earnings on Mutual Fire assets which are collateral held by financial institutions shall continue to accrue to the benefit of Mutual Fire's estate. Any excess collateral under a letter of credit or trust shall be returned to the Rehabilitator forthwith.

B. **Class 2: Administrative Claims**

Administrative Claims shall be reserved and paid in full and in cash not later than the Effective Date, and from time to time thereafter, as provided in Section XI of this Plan.

1. Mutual Fire's Administrative Claims. Administrative Claims shall include, but not be limited to, the actual, reasonable, and necessary costs of preserving or recovering the assets of Mutual Fire and the costs of goods and services provided to Mutual Fire's estate, including the fees and expenses of professionals approved by the Court. The fees and expenses of outside counsel shall be subject to initial review by the Rehabilitator and subject to final review and approval by the Court.

2. Guaranty Association Expenses. The actual, reasonable, and necessary expenses (other than Loss Adjustment Expenses) of a Guaranty Association which are afforded administrative priority under law shall be paid in full from time to time as allowed by the Court after review.

C. Class 3: Wage Claims

Wages due to employees (excluding officers and directors) of Mutual Fire, not to exceed $1,000 per employee, for services actually performed within one year prior to the Petition Date shall be paid in full and in cash on the Effective Date. Any other Claims

of Employees shall be classified and treated as Unsecured Claims under Class 6. Claims of officers and directors of Mutual Fire shall be classified and treated under Class 10.

D. Class 4: Policyholder Loss Claims.

1. After Classes 2 and 3, the following Loss Claims, without distinction or subclasses among them, shall be accorded the first priority of distribution among unsecured Creditors:

a. Adjusted Claims for reimbursement of amounts actually expended by Policyholders for Losses incurred under policies, including reasonable Loss Adjustment Expenses actually expended, to the extent covered by a policy.

b. Adjusted Claims for Losses incurred but not paid by Policyholders under first party property or other policies and under liability policies, including reasonable Loss Adjustment Expenses actually incurred, to the extent covered by a policy.

c. Adjusted Claims for Third Party Loss Claims for amounts owed to Claimants (other than Cedents and Surety Bond Lenders) under laws that permit direct rights of action against Mutual Fire, as permitted and to the extent covered by a policy.

2. Class 4 Claims shall be paid according to the Proportional Payments Method described in Section VI of the Plan.

3. Except for Claims of Guaranty Associations qualifying in Class 2 (administrative expenses), Guaranty Associations that properly pay Claims in accordance with applicable state law shall be subrogated to Claims they have paid and shall be accorded the same priority and testament as those Claims would have had under Class 4, if not paid by a Guaranty Association.

4. Claims of Policyholders for unearned premiums and subrogated claims of Guaranty Associations for unearned premiums paid by Guaranty Associations shall be classified and treated as Unsecured Claims under Class 6.

E. Class 5: Surety Bond Lenders

1. The amounts of unsecured Surety Bond Lender Claims that cannot be satisfied through reasonable efforts of the Surety Bond Lenders to collect defaulted loans shall be determined by the Rehabilitator and satisfied from such assets of Mutual Fire, other than the Class 6 Fund, as may be available after Claims of Classes 2 through 4 are paid or reserved for payment in full provided, however, that the Surety Bond Lender has neither released, satisfied, waived,

prejudiced, extinguished or otherwise modified in any manner whatsoever, the subrogation rights of Mutual Fire to recover any such deficiencies or collect the unpaid balance of any Note directly from the partnership, the individual defaulted investors, assignees or other third parties, which right Mutual Fire would have had pursuant to the Surety Bond, or otherwise.

2. All Claims of Surety Bond Lenders shall be net of any recoveries and no payments shall be made to Class 5 Claimants without satisfactory documentary evidence of the validity of the Claim. Any Surety Bond Lender making a Claim against Mutual Fire shall submit a complete accounting to the Rehabilitator of all monies received, the date of all such payments and the source, which accounting shall include payments made by Mutual Fire. Surety Bond Lenders shall periodically update their accountings. The Rehabilitator shall retain the right to review and contest the reasonableness of settlements and collections made by Surety Bond Lenders.

3. Class 5 Claims shall be paid in full before any distributions are made with respect to Class 6 claims except that

the Class 6 Fund shall be used for the exclusive benefit of Class 4 or Class 6 Claimants pursuant to the provisions of Section II F, below.

4. No interest shall accrue on Claims of Surety Bond Lenders after June 13, 1986.

F. **Class 6: General Unsecured Claims**

The claims of general Unsecured Creditors in Class 6 shall include all Claims other than Claims included in Classes 1, 2, 3, 4, 5, 6, 7, 8, 9 and 10. Class 6 Claims shall be paid in full to the extent of cash available after full payment has been made to or provided for Classes 2, 3, 4, and 5.

1. Creation of Class 6 fund. On or before the Effective Date, a segregated account (the "Class 6 Fund") shall be established by the Rehabilitator. The Class 6 Fund shall be funded by depositing in the Class 6 Fund, from time to time, twenty-five percent (25%) of all Reinsurance collected by Mutual Fire, with repect to the assumed reinsurance business of Mutual Fire. All interest earned shall be transferred to the general account of the Rehabilitator and used by the Rehabilitator as a general unliened asset of the estate of Mutual Fire.

2. Distributions to Class 6 Claimants.

Distributions from the Class 6 Fund shall be made in the discretion of the Rehabilitator following the date upon which the Court enters an Order authorizing an initial distribution to Class 6 Claimants (the "Initial Distribution Order"). The amount of, and mechanics for, such distributions shall be determined by the Rehabilitator. No portion of the Class 6 Fund shall be used for the payment of Class 5 Claims unless and until such time as all Class 6 Claims have been paid in full.

3. Surplus. In the event that all Class 6 Claimants have been paid or provided for in full, the Rehabilitator may, with the approval of the Court after notice and hearing, withdraw the surplus from the Class 6 Fund for payment to other Claimants under this Plan.

4. Initial Distribution Order. No distributions to Class 6 Claimants may be made until the Court has entered the Initial Distribution Order. The Initial Distribution Order shall be entered only after motion requesting such relief and only after notice, hearing and the Court's determination that sufficient funds have been collected to pay all

Administrative Claims and to pay or reserve for all Class 4 Claims under the Proportional Payment Method.

G. Class 7: Claims of the Federal or any State or Local Government

Claims of the Federal, any state or local government or agencies of any of the foregoing shall be paid in full to the extent of cash available after full payment of all Class 6 Claims.

The Rehabilitator shall set aside funds which she deems adequate to satisfy any and all possible debts due to the United States Government from the Mutual Fire, Marine and Inland Insurance Company's (Mutual Fire) estate. The Rehabilitator shall advise the Court when this amount is determined and describe the nature of the potential claims for which funds have been set aside. The Rehabilitator shall also notify the United States Government of its determination.

H. Class 8: Late Claims

Loss Claims reported after June 30, 1991 ("Late Claims") shall be paid in full to the extent of cash available after full payment of all Class 7 Claims. No cutoff date for the reporting and

filing of Late Claims is fixed herein. The right is reserved to the Rehabilitator to seek, at a later date, Court approval of a cutoff date for the reporting and filing of Late Claims.

I. **Class 9: Holders of Surplus and Contribution Notes**

To the extent of cash available after full payment of all Class 8 Claims, payment shall be made in full to such holders of surplus or contribution notes or similar obligations as may exist.

J. **Class 10: Owners, Officers and Directors**

To the extent of cash available after full payment of all Class 9 Claims, payments shall be made to Policyholders as of December 4, 1986, other than in their capacity as Class 4, in proportion to the annual premiums for the policies then in force.

SECTION III.
SETOFF

Regardless of any provision in a reinsurance contract or other agreement, mutual debts and credits between Mutual Fire and other persons may be setoff on the following basis:

A. Mutual Debts and Credits

Mutual debts and credits may be setoff only on a company by company basis. For purposes of the Plan, a company shall mean a corporation or other legal entity with independent legal existence, capable of suing and being sued in its own name.

Except as hereinafter provided, mutual obligations may not be aggregated and setoff against each other. If the net amount is owed to Mutual Fire by the other company, it shall be paid forthwith to Mutual Fire in full. If the net amount is owed by Mutual Fire, that amount may be claimed according to the priorities of distribution described in Section II of this Plan.

B. Other Obligations

Regardless of any provision in a reinsurance contract

or other agreement, obligations to pay premiums to Mutual Fire may not be setoff against other obligations. Premiums owed to Mutual Fire shall be paid forthwith in full.

C. **Criteria**

Claims are mutual if they satisfy the following criteria:

1. To be mutual, Claims must be mutual at the time the obligations were incurred.

2. Claims do not become mutual by assignment, by reorganization of companies, or by any other means, if the result would be to permit setoff that otherwise would not be available absent such assignment, reorganization or other means.

3. Claims are mutual only if the parties are acting in the same capacity with respect to the Claims they seek to setoff.

D. **Setoff Calculated As of December 31, 1986**

Setoff for purposes of this Plan shall be calculated as of December 4, 1986. No setoff shall be allowed or paid in those situations described in 40 P.S. Section 221.32(b)(1) through (4). Within

ninety (90) days of final approval of the Plan, the Department shall notify each creditor of the amount of setoff as calculated by the Rehabilitator. This notice shall contain a statement advising each creditor that it shall have thirty (30) days from receipt of said notice to object to the Rehabilitator's calculation, or that calculation shall be deemed final. In the event of an objection, the dispute shall be resolved pursuant to the Claim Resolution Procedures set forth in Section VII of this Plan.

The only mutual debts and credits that may be setoff against one another are those Due and Owing on December 31, 1986.

To the extent any Reinsurer who is also a Cedent is permitted a setoff, Mutual Fire shall receive all payments due from the retrocessionaries that are attributable to the Claims of the ceding company that are satisfied by application of the setoff, and such sums shall not be deposited in the Class 6 fund.

E. **Election of Optional Setoff Definition**

1. Election. A Reinsurer who is also a Cedent may pay that amount carried on the books of Mutual Fire as currently

due and owing within ninety (90) days after the date on which the Court enters an Order approving and confirming the Plar., in which event the Optional Setoff Definition set forth below shall apply to said Reinsurer.

2. Optional Setoff Definition. The Optional Setoff Definition shall be as follows:

Any Reinsurer of Mutual Fire who is also a cedent to Mutual Fire will be permitted to setoff the lesser of Mutual Fire's obligations to the Cedent against the Reinsurer's obligations to Mutual Fire according to Mutual Fire's books pursuant to the following calculation:

Option Setoff Calculation - The lesser of:

a. Mutual Fire's obligation to the Cedent for: balances Due and Owing, plus reported Case Reserves plus reported IBNR.

All as computed as of December 4, 1986; or

b. The Cedent's obligation to Mutual Fire balances Due and owing, plus Case Reserves.

All as computed as of December 4, 1986.

Mutual Fire's IBNR is specifically excluded from section (b.) of this calculation.

To the extent that Case Reserves are set off and the claims relating to those case reserves ultimately are settled as a value less than the reserved amount, Reinsurer who is also a Cedent shall remit, in cash, the balance to Mutual Fire.

3. To the extent any Reinsurer who is also a Cedent is permitted a setoff, Mutual Fire shall receive all payments due from the Retrocessionaries that are attributable to the Claims of the ceding company that are satisfied by application of the setoff and such sums shall not be deposited into the Class 6 Fund.

F. Reinsurance Discount

Reinsurance who pay that amount carried on the books of Mutual Fire as currently due and owing within ninety (90) days after the date on which the Court enters an Order approving and confirming the Plan shall receive a ten percent (10%) discount. In order to qualify for the discount contained herein, a Reinsurer must waive any right to setoff.

SECTION IV.
MARSHALING OF ASSETS

A. The Rehabilitator shall collect and liquidate assets including the collection of claims against Reinsurers, and liquidation of personal property (tangible and intangible), and claims against third parties and other claims on an ongoing basis.

B. The Rehabilitator shall adjust Claims on an ongoing basis as provided in Section VII of this Plan.

C. The Rehabilitator shall pay Claims to the extent of Mutual Fire's assets available to pay claims, in priority of payment as set forth in Section II of this Plan. Except as otherwise provided in this Plan, payment in full shall be made for each Class of Claims before any payments are made on Claims of junior classes.

SECTION V.
GUARANTY ASSOCIATIONS

A. Distributions to Guaranty Associations

1. Guaranty Associations shall be entitled to reimbursement from the estate in the manner and amount set forth in this Plan for Policyholders and Claimants, only on the basis of actual payments made by the association to or on behalf of said Policyholders and Claimants.

2. In addition to such other information as the Rehabilitator may require, the Guaranty Associations shall be required to submit to the Rehabilitator the following information with respect to each Policyholder and Claimant in their respective states: the name and address of the Policyholder or Claimant; the total amount of the allowed Claim; the total amount paid by the association in reimbursement of the claim; and the total amount paid by the association in outside lawyer and adjustor fees for the benefit of such Policyholder or Claimant.

B. Distributions to Claimants in Guaranty Fund States

1. A Policyholder or Claimant who is entitled to reimbursement from a Guaranty Association may receive a distribution under this Plan only in those circumstances in which the total percentage of reimbursement which such Policyholder or Claimant has received from the Guaranty Association is less than the percentage of reimbursement distributed to Creditors of the same priority under the Plan that do not qualify for Guaranty Association coverage. In such cases, such Policyholder or Claimant may receive such additional distribution under this Plan as are required to provide such Policyholder or Claimant with a total percentage of reimbursement equal to that received by Creditors of the same priority under the Plan who are not eligible for reimbursement from guaranty Associations. In computing the total percentage of reimbursement received by a Policyholder or Claimant from a Guaranty Association, the Rehabilitator shall include and consider any amounts paid by the Guaranty Association on behalf of such Policyholder or Claimant to outside vendors such as independent adjusters and attorneys.

2. There shall be no duplication of payments hereunder to a Guaranty Association and the Policyholders or Claimants

subject to reimbursement by such Guaranty Association.

SECTION VI.
PROPORTIONAL PAYMENTS METHOD

A. Interim Partial Payments

Interim partial payments shall be made periodically on Class 4 Adjusted Claims (Policyholder Loss Claims and Guaranty Association Loss Claims) as cash is available, in the manner set forth below.

1. The first distribution to Class 4 shall be made as soon as practicable following the Effective Date of this Plan but no later than December 1, 1990. The Rehabilitator shall pay after the Effective Date Class 4 Adjusted Claims of $5,000.00 or less per Adjusted Claim as and when adjusted out with the first payment not later than June 1, 1990.

2. Unless otherwise ordered by the Court, distributions shall thereafter be made to Class 4 Adjusted Claims at least annually.

3. Payments of Class 4 claims to Class 4 claimants with more than one claim under $5,000.00 shall be treated as

advances against distributions under the Proportional Payments Method described herein. No Class 4 claimants who receive payment for multiple small claims shall receive distribution under the Proportional Payment Method until all the Class 4 claimants first receive an equal percentage distribution on their adjusted claims.

B. Available Cash

Cash available to pay Class 4 Claims, after setting aside a reserve for Classes 2 and 3, as directed by the Court from time to time, shall be allocated proportionally among the following categories:

1. Adjusted Claims
2. Case Reserves and IBNR.
3. Estimation Margin.

C. Amounts to Be Allocated

In order to determine the amounts to be allocated, the total amount of Class 4 Adjusted Claims, actuarial estimates of Case Reserves, IBNR and Estimation Margin shall be determined from time to time as of a Record Date. Simultaneously with

each Record Date a Distribution Date shall also be fixed not less than sixty (60) days following the Record Date.

1. Claims adjusted on or before each periodic Record Date shall qualify thereafter to receive partial distributions until such time as the Claims are paid in full or Mutual Fire's assets available to pay Class 4 Claims are exhausted, whichever event occurs first.

a. Cash allocated to Adjusted Claims, section VI B. 1., shall be paid to Policyholders and Third Party Loss Claimants in proportion to the amount each Adjusted Claim bears to the cumulative total of all Adjusted Claims on each Record Date.

b. The first distribution respecting claims adjusted between Record Dates ("later-Adjusted Claims") shall cause each such Claim to receive an amount equal to the cumulative percentage paid on earlier Adjusted Claims so that all Adjusted Claims as of a given Record Date shall receive, on a cumulative basis, proportionally equal distributions as of each Distribution Date.

c. Claimants with Adjusted

Claims that already have received a distribution shall not receive a further distribution unless and until sufficient cash is available to pay and reserve for later-Adjusted Claims so that later-Adjusted Claims may receive, on a cumulative basis, proportionally equal distributions.

D. Cash distributions shall be made only with respect to Adjusted Claims.

2. Cash allocated to categories VI B. 2., and 3 (Case Reserves, IBNR, and Estimation Margin) shall be segregated by the Rehabilitator.

3. At each Distribution Date the funds segregated and held by the Rehabilitator, including investment earnings thereon, plus any amount in excess of the reserve for Classes 2 and 3, shall be allocated among the categories of Adjusted Claims, Case Reserves, IBNR, and Estimation Margin, as described above.

4. Upon notice as the Court shall require, all assets held and segregated pursuant to this Section VI by the Rehabilitator, after Class 4 Claims are paid in full or reserved for payment in full, shall be released for payment to Classes 5 through 10.

D. Effect of Payments by Guaranty Associations

So long as interim partial payments are made, they shall continue to be made to Guaranty Associations on the same basis as to Policyholders not entitled to Guaranty Association coverage to reimburse them, on a Claim by Claim basis, for Loss Claims paid by the Guaranty Associations, until the Guaranty Associations are reimbursed in full. No payment shall be made to any Policyholder of claimant on account of the Guaranty Association deductible. After Guaranty Associations have been reimbursed in full, proportional payments shall be made pursuant to the Proportional Payments Method to Class 4 Claimants paid by Guaranty Associations for any remaining amounts of loss Claims not satisfied by Guaranty Associations.

E. Annual Review By The Court

At least once each year, the Rehabilitator shall seek Court approval, regarding:

1. The amounts that should be set aside for Claims of Classes 2 and 3;

2. The amounts of available cash that should be

segregated;

3. The amounts of Class 4 Claims represented by categories VI B. 1 to 3 (Adjusted Claims, Case Reserves, IBNR and Estimation Margin); and

4. The next Record Date and Distribution Date.

F. Actuarial Analysis

Actuarial analysis of case Reserves, IBNR, and Estimation Margin shall be made by independent actuaries having experience with property and casualty insurance loss reserves, selected by the Rehabilitator and approved by the Court.

G. Cutoff Date For Submission of Loss Claims

No Loss Claim (Class 4) which is reported subsequent to June 30, 1991 will be allowed, recognized or paid in Class 4 and all Loss Claims reported subsequent to June 30, 1991 will be barred and disallowed as Class 4 Claims. Loss Claims must be reported to Mutual Fire in writing and date stamped by Mutual Fire. Loss Claims reported to Mutual Fire after June 30, 1991 will be Late Claims and included in Class 8.

The bar date for filing proofs of claim with Mutual Fire for Class 3 Claims and for all Class 6 Claims other than Unsecured Claims of Cedents shall be three (3) months from the date of the Order confirming this Plan.

No cutoff date for the filing of Unsecured Claims of Cedents or Surety bond Lenders is fixed herein. The right is reserved to the Rehabilitator to seek at a later date Court approval of a cutoff date for the filing of proofs of claim by Unsecured Cedents and Surety Bond Lenders. No Class 3 Claim or Class 6 Claim (other than Unsecured Claims of Cedents) filed after three (3) months from the date of the Order confirming this Plan will be allowed, recognized or paid. Class 3 Claims or Class 6 Claims (other than Unsecured Claims of Cedents) filed after three (3) months from the date of the Order confirming this Plan will be Late Claims and included in Class 8.

Claims, to be allowable, must either be fixed by settlement or judgment on the merits after trial or must be provable to the extent that the proof offered is such that the Claimant would be entitled to obtain a judgment upon such Claim against Mutual Fire.

Judgements entered by default will not be recognized or considered binding.

H. Subrogation

Payments of Loss Claims and loss Adjustment Expenses shall be made notwithstanding, and the timing of such payments shall not be delayed on account of, any claims against or recoveries from third parties by any Policyholder arising out of a loss that is covered under the Policyholder's policy. To the extent that payment is made to a Policyholder under this Plan, Mutual Fire shall be subrogated to all such rights of recovery of the Policyholder against third parties to the extent provided by the applicable insurance policy or by applicable law. This Plan shall not be construed to either enlarge or restrict Mutual Fire's right to subrogation under any policy of insurance or applicable law.

SECTION VII.
CLAIM RESOLUTION

The Rehabilitator shall review and adjust all Claims. When a Claim is denied by the Rehabilitator in whole or in part, written notice of the determination shall be given to the Claimant and its attorney, if any, by first class mail at the address shown in the proof of claim. Within sixty (60) days from the date of mailing of the notice, the claimant may file objections with the Court and serve a copy of any objections on the Rehabilitator and her counsel. If no such filing and service is made, the Claimant may not further object to the determination.

Whenever objections are filed and served, the Rehabilitator shall seek a hearing and give notice of the hearing by first class mail to the Claimant or its attorney not less than thirty (30) days before the date of the hearing. The matter may be heard by the Court or by a court appointed referee or master who shall submit findings of fact along with his recommendation. Claimants shall cooperate with the Rehabilitator in an effort to settle and adjust Claims.

One or more representatives of Mutual Fire's Reinsurers may

(but need not) be appointed by the Court on the recommendation of the Rehabilitator to consult with the Rehabilitator in her review of Claims and in her consideration of settlements, adjustments and reimbursement agreements. Any such representatives shall serve without compensation and shall have no authority to employ professionals or incur expenses.

SECTION VIII.
JURISDICTION

Pursuant to 40 P.S. 221.4, the Court shall retain exclusive jurisdiction of these proceedings and all matters relating to the implementation and consummation of the Plan. Such jurisdiction shall include, but not be limited to, the following:

(a) to consider any modification or amendment to the Plan;

(b) to hear and determine all controversies, suits and disputes that may arise in connection with the interpretation or enforcement of the Plan;

(c) to hear, determine and where appropriate refer to arbitration, all disputes concerning Claims and the collection of assets of Mutual Fire, including reinsurance and retrocessions;

(d) to approve, and/or set guidelines for the settlement, commutation, compromise or

disposition of any claim against Mutual Fire or any cause, right, or asset (tangible or intangible) of Mutual Fire;

(e) to appoint masters, referees and arbitrators as necessary or appropriate to submit findings of act and recommendations;

(f) to consider and act on any other matter related to the Plan.

SECTION IX.
LOSS ADJUSTMENT EXPENSES

The Rehabilitator shall continue to make payments for all reasonable costs and fees incurred by her or her authorized claim adjustors and agents retained in connection with the adjustment, investigation and defense of claims asserted directly against Mutual Fire.

Loss Adjustment Expenses related to the employment of all investigators, adjusters and counsel who were retained by the Rehabilitator or Mutual Fire or either of their authorized agents to investigate, adjust and defend claims asserted against Mutual Fire's Policyholders ("Professionals") shall be shared equally by Mutual Fire and its Policyholders effective April 23, 1990. The Rehabilitator reserves the right to further reduce or terminate payment of Loss Adjustment Expenses in the event that cash flow is inadequate. Loss Adjustment Expenses will be paid as aforesaid by Mutual Fire only if Policyholders pay their share of Loss Adjustment Expenses and retain the services of Professionals previously approved or hereafter approved by the Rehabilitator.

The Professionals shall submit to the Rehabilitator invoices for services rendered and reimbursement of expenses incurred.

The Rehabilitator shall review all invoices submitted by the Professionals, which invoices shall include a detailed description of services rendered with rates and time expended and substantiation for expenses for which reimbursement is sought.

The Rehabilitator shall submit to the Court for approval any requests for compensation and reimbursement of expenses of the Professionals as determined by the Rehabilitator to be fair, reasonable and prudent.

The Rehabilitator may seek leave of the Court to pay all Loss Adjustment Expenses for investigators, adjustors and counsel to defend Claims asserted against policyholders who demonstrate financial hardship and an inability to otherwise provide for a defense.

The partial discontinuance of payment of loss Adjustment Expenses as provided herein shall not affect or reduce the obligations and liability to Mutual Fire and the Rehabilitator of Reinsurers under contracts, agreements and treaties providing for reinsurance of

obligations of Mutual Fire.

Nothing contained herein is intended to or shall relieve any of Mutual Fire's managing general agents of their duties and obligations to Mutual Fire and to the Rehabilitator.

The Rehabilitator may continue in her discretion to employ investigators, adjustors and counsel to defend direct actions against Mutual Fire and/or the Rehabilitator.

Policyholders may include in their Claims against Mutual Fire, for further review and consideration by the Rehabilitator, all costs incurred in defending insured Claims, which costs would have been paid by Mutual Fire except for the suspension of certain Loss Adjustment Expenses herein. The Rehabilitator and Mutual Fire shall not be bound by adjustments and settlements entered into by Policyholders unless approved by the Court.

SECTION X.
DISPUTE RESOLUTION

A. Any party to a dispute (other than disputed Claims which shall be resolved pursuant to Section VII of this Plan) in which the rights of all necessary parties are within the scope of an arbitration clause by which all such parties would be bound absent these Rehabilitation proceedings may petition the Court and request that the dispute be resolved by the Court rather than by arbitration. The Court shall grant such a petition in its discretion based upon a determination that resultion by the Court is in the best interest of the estate and will not unduly prejudice any party to the dispute.

B. Disputes not subject to a valid and binding arbitration clause shall be heard and determined by the Court.

C. The Court may appoint from time to time one or more special masters to hear and make a preliminary determination on factual and legal issues that are not subject to or are not suitable for arbitration under this Plan.

D. The Court shall retain jurisdiction to establish

schedules for arbitrations, to review discovery orders, to appoint arbitrators where the parties fail to do so, to approve Mutual Fire's appointment of qualified arbitrators and selection of umpires, to determine significant questions of law to avoid unnecessary litigation, and otherwise to review arbitrations where the law of the Commonwealth of Pennsylvania or other applicable law permits or requires.

E. Arbitration panels and special masters may apply to the Court for enforcement of such procedural, discovery, and other orders of such panels and masters as may be necessary or appropriate for the expeditious and fair resolution of disputes.

SECTION XI.
ADMINISTRATIVE EXPENSE PROCEDURES

The Rehabilitator shall have full power to direct and manage, to hire, compensate and discharge employees subject to any contract rights they may have, and to deal with the property and business of Mutual Fire.

A. No administrative expenses other than ordinary and necessary expenses, or under contracts separately approved by the Rehabilitator, may be paid until approved by the Court.

B. Professionals approved by the Court to perform services for Mutual Fire or the Rehabilitator shall submit fee applications to the Court for approval in a form adequate for the Court to determine whether professional fees and expenses are necessary, reasonable, and prudent.

C. Loss Adjustment Expenses incurred in connection with the adjustment, investigation and defense of claims asserted directly against Mutual Fire, including the costs of counsel, claims adjusters, and others providing services to or on behalf of Mutual

Fire shall be submitted at least quarterly for approval of the Court.

D. Defense attorneys (except for closed cases) and other vendors of services qualifying as Loss Adjustment Expenses shall submit a monthly summary of all such expenses incurred on behalf of Mutual Fire from June 13, 1986, to the date of the loss adjustment expense application, indicating:

1. The specific matter or matters to which the work and out of pocket expenses relate;

2. Hourly rates or other basis for determining professional fees, which shall be subject to approval by the Court unless set forth in a prior contract with the Rehabilitator;

3. The amounts of such fees and expenses for which payment has been received from Mutual Fire and the basis for determining such charges; and

4. The amounts of such fees and expenses that have not been paid and the basis for determining such charges.

SECTION XII.
PAYMENT OF PREMIUMS TO MUTUAL FIRE

A. An Agent, broker, premium finance company, Cedent, Reinsurer or any other person, including Policyholders, responsible for the payment of a premium or returned premium shall be obligated to pay any unpaid premiums, whether earned or unearned. No credit or setoff shall be allowed in favor of such person against his account with Mutual Fire, for the unearned portion of the premium on any canceled policy, unless (i) that policy was canceled prior to the entry of the Suspension Order of September 12, 1986, and (ii) the unearned premium on the canceled policy was in fact refunded or credited to the insured or his assigns prior to the entry of said Order. The Rehabilitator shall also have the right to recover from such person any part of an unearned premium that represents a commission to such person.

B. Policyholders shall be obligated to pay any unpaid earned premium due at any time to Mutual Fire.

SECTION XIII.
INJUNCTION; NON-INTERFERENCE; AND DEALING WITH MUTUAL FIRE POST CONFIRMATION

A. All Reinsurers and managing or underwriting agents, and all agents, officers, attorneys, directors and employees thereof and all persons in active concert or participation therewith are enjoined from commencing or continuing any action or proceeding (whether legal, equitable, administrative, or judicial in nature) to determine or adjudicate any right or obligation of Mutual Fire, except in the Court or in accordance with a procedure approved by the Court.

B. No action at law or equity shall be brought against Mutual Fire or the Rehabilitator, or any employee, agent or representative of the Rehabilitator, whether in the Commonwealth of Pennsylvania or elsewhere, nor shall any such existing counterclaim or setoff be asserted in any action brought by or on behalf of the Rehabilitator, whether in Pennsylvania or elsewhere, except as permitted under the terms of this Plan or by the Court.

C. The officers, directors, trustees, Policyholders, agents and employees of Mutual Fire, and all other persons, are permanently

enjoined and restrained from making or executing any levy upon the property or estate of Mutual Fire, or from in any way interfering with the Rehabilitator in her possession, control or management of Mutual Fire, or in the discharge of her duties, or in the rehabilitation of the business of Mutual Fire.

D. The officers, directors, trustees, Policyholders, agents and employees of Mutual Fire, and all other persons, having any property or records belonging to Mutual Fire, including data processing information, systems and records of any kind such as, by way of example only, source documents, are hereby directed to assign, transfer and deliver to the Rehabilitator all of such property in whatsoever name the same may be, and any persons, firms or corporations having any books, papers or records relating to the business of Mutual Fire shall preserve the same and submit these to the Rehabilitator for examination at all reasonable times.

E. All persons, firms, governmental and business entities and corporations are hereby permanently restrained and enjoined from instituting, prosecuting or pursuing, or attempting to institute, prosecute,

or pursue, any suits or proceedings, at law or in equity or otherwise, against Mutual Fire or its successors or assigns or against any of the assets or property of Mutual Fire or its successors or assigns, directly or indirectly, on account of or based upon any right, claim or interest of any kind or nature whatsoever which any such person, firm, governmental or business entity or corporation may have in, to or against Mutual Fire, or any of its assets or properties, and from interfering with, attaching, garnishing, levying upon, enforcing liens against or upon, or in any manner whatsoever disturbing, any portion of the property, real, personal or mixed of any kind or character, on or at any time after the date of the Order approving and confirming this Plan in the possession of Mutual Fire, and from interfering with, or taking steps to interfere with Mutual Fire, its officers and agents, or the operation of the properties or the conduct of the business of Mutual Fire, by reason or on account of any obligation or obligations incurred by Mutual Fire, except the obligations imposed upon Mutual Fire by the Plan or by the Order approving and confirming this Plan. All persons, firms, governmental and business entities and corporations are hereby restrained and enjoined

from instituting, prosecuting, or pursuing or attempting to institute, prosecute or pursue any suit or proceeding, at law or in equity or otherwise, against Mutual Fire or any of its assets or property, directly or indirectly, except such suits or proceedings as may be for the purpose of carrying out this Plan or the Order approving and confirming this Plan.

SECTION XIV.
CORPORATE RESTRUCTURE

The Rehabilitator will evaluate the potential for corporate restructuring of Mutual Fire in order to provide additional assets. Upon completion of the Rehabilitator's evaluation, the Rehabilitator will notify interested parties and file with the Court recommendations regarding the alternatives available that would leave Mutual Fire with the capital and surplus required by Pennsylvania law. The Rehabilitator will evaluate the potential for consolidation, conversion to stock form, or merger of Mutual Fire and shall submit her report to the Court. Mutual Fire shall maintain on deposit with the Commonwealth of Pennsylvania the minimum capital and surplus required under Pennsylvania Law.

Any discharge of indebtedness pursuant to this Plan shall be treated as an adjustment to surplus.

SECTION XI.
MISCELLANEOUS PROVISIONS
CONCERNING REINSURANCE

A. Nothing contained in this Plan shall release or diminish any claim that Mutual Fire or the Rehabilitator may have against Reinsurers or Retrocessionaires for the full amount of Reinsurance applicable to any Claim, whether or not Mutual Fire has paid the Claim in whole or in part.

B. Nothing contained in this Plan shall release or diminish the obligation of a Reinsurer or Retrocessionaire of Mutual Fire to pay the full amount of Reinsurance applicable to any claim.

C. Reinsurance obligations to Mutual Fire shall become due and owing immediately upon reporting by Mutual Fire of adjustment of Loss Claims and Mutual Fire shall have no obligation to pay any Loss Claims as a condition precedent to collection of Reinsurance.

D. A Reinsurer or Retrocessionaire that makes a payment to Mutual Fire during the period of Rehabilitation proceedings shall not be required to pay such sums again in the event of subsequent liquidation proceedings.

E. Interest shall be charged on Reinsurance balances due for paid or adjusted Losses beginning ninety (90) days after the balance due was billed to the Reinsurer for all amounts ultimately found due and owing Mutual Fire by a Reinsurer. The interest rate that shall be charged for balances due shall be six percent (6%) percent per annum, compounded daily.

F. Direct actions by Creditors or their assigns against Mutual Fire's Reinsurers are prohibited.

May on a case by case basis consider and pay hardship Claims and Loss Adjustment Expenses of Policyholders.

E. Policy Limits

No Adjusted Claim under a policy of insurance shall be allowed for an amount in excess of the applicable policy limits. If several Adjusted Claims founded upon one policy are made, and the aggregate allowed amount of the Adjusted Claims to which the same limit of liability in the policy is applicable exceeds that limit, each Adjusted claim as allowed shall be reduced in the same proportion so that the total equals the policy limit.

F. Subsequent Liquidation

Distributions and other payments made to Claimants under this Plan shall not be set aside or contested by a Liquidator in the event of liquidation of Mutual Fire.

G. Full Powers of the Rehabilitator

The Rehabilitator and, as delegated by the Rehabilitator, her Special Deputies, shall have the full powers delegated under Article 5 of the Insurance Department Act of 1921, as amended, any additional powers delegated by Order or ruling of Court, (including but not limited to Order of Court dated December 8, 1986), and any other powers granted by other provisions of the law. The powers thus conferred upon the Rehabilitator and her Deputies include, but are not limited to, the right to take legal action against Reinsurers, officers and directors, managers, general agents, employees, or any other persons, where recovery in such an action will inure to the benefit of Policy holders, Cedents and other Creditors.

H. Reservation of Rights

The descriptions of the rights, title and

interests of Mutual Fire, Policyholders, Creditors and other parties in interest whose Claims are treated herein are not admissions as to the rights, title and interests of any such entity but merely an indication of what rights and status shall be granted to such entity if the Plan is confirmed in substantially this form, and implemented.

I. Dissolution of Committee of Policyholders

Upon the date of an order of the Court approving and confirming this Plan the Official Committee of Policyholders shall be dissolved and professional persons employed by said Committee shall not be compensated from the assets of the estate of Mutual Fire thereafter.

J. Continuance of Coverage

All policies of insurance written by Mutual Fire in effect at the time of issuance of an Order of the Court approving and confirming this Plan shall continue in full force only with respect to the risks in effect, at that time (I) for a period of thirty (30) days from the date of said Order; (ii) until the insured has replaced the insurance coverage with equivalent insurance in another insurer or otherwise

terminated the policy, whichever time is less.

K. Preservation of Remedies

Payment of an Adjusted Claim shall not preclude the Rehabilitator from subsequently pursuing any remedies at law or in equity against a Policyholder or Claimant.

SECTION XVIII.
INTEREST

Except as may be otherwise provided for in this Plan, or as may be otherwise required under applicable law, all Creditors holding Unsecured Claims shall waive interest, late charges, penalties, attorneys' fees and court costs against Mutual Fire and the Rehabilitator except for attorneys' fees and costs approved for reimbursement by Order of the Court prior to the Effective Date and all Creditors shall waive all claims against any disbursing agent and any entity disbursing funds for interest, including interest on funds to be distributed under the Plan, late charges, penalties, attorneys fees, court costs and any other charges of any kind for which payment is not expressly provided for in this Plan.

SECTION XVIII.
DISCHARGE

Mutual Fire, as of the date of the Order approving and confirming this Plan, shall be discharged and released from all of its obligations, debts, liabilities and claims, whether or not filed or presented, whether or not approved, acknowledged or allowed by Mutual Fire, (or in these proceedings), or whether or not provable in bankruptcy or otherwise, except for the obligations imposed upon Mutual Fire by the Plan or by the Court.

Dated: January 31, 1989 Respectfully submitted,

_____

Constance B. Foster
Insurance Commissioner
of the Commonwealth
of Pennsylvania, as
Rehabilitator of The Mutual
Fire, Marine & Inland
Insurance Company

ADELMAN LAVINE GOLD AND LEVIN

BY: _____

Robert H. Levin, Esquire
Outside General Counsel

to Constance B. Foster,
Insurance Commissioner, as
Rehabilitator of The
Mutual Fire, Marine &
Inland Insurance Company
1900 Two Penn Center Plaza
Philadelphia, PA 19102-1799
(215) 568-7515

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Dated: January 30, 1989 Respectfully submitted,

/s/ Constance B. Foster
CONSTANCE B. FOSTER
Insurance Commissioner
of the Commonwealth of
Pennsylvania, as
Rehabilitator of The Mutual
Fire, Marine & Inland
Insurance Company

ADELMAN LAVINE GOLD AND LEVIN

BY:/s/ Robert H. Levin
ROBERT H. LEVIN, ESQUIRE
Outside General Counsel
to Constance B. Foster,
Insurance Commissioner, as

Rehabilitator of The
Mutual Fire, Marine & Inland
Insurance Company
1900 Two Penn Center Plaza
Philadelphia, PA 19102-1799
(215) 568-7515

IN THE COMMONWEALTH COURT
OF
PENNSYLVANIA

GEORGE F. GRODE, INSURANCE COMMISSIONER OF THE COMMONWEALTH OF PENNSYLVANIA	:	
PLAINTIFF	:	
V.	:	no. 6483 C.D. 1986
THE MUTUAL FIRE, MARINE AND INLAND INSURANCE COMPANY,	:	
DEFENDANT		

ORDER

Upon consideration of the applications of the Rehabilitator and various other parties for clarification of this Court's January 12, 1990 Order, said Order is amended to conform with this court's direction that all provisions on the conclusiveness of Mutual Fire's books and records contained in the Rehabilitator's Modified Plan of Rehabilitation be stricken.

The sentence, "Balances set forth on the books of Mutual Fire shall be conclusive for this purpose," is hereby stricken from Sections III, E. I and III, G. Of the Rehabilitator's Modified Plan of

Rehabilitation.

Date: April 16, 1990

s/ James Crumlish, Jr.
James Crumlish, Jr.
President Judge

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE
NASHVILLE, TENNESSEE

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED, Special Deputy Commissioner of) Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company,	)	
Plaintiff	)	
vs.	)	File No. 3-90-0581
E.W. BLANCH CO., E.W. BLANCH, Jr., General Partner, MICHAEL W. CASHMAN, SR., General Partner, and FRANK S. WILKINSON, General Partner,	)	
Defendants.	)	

DEPOSITION OF

LEO T. HEIFETZ

VOLUME I

AUGUST 22, 1991
9:15 a.m.

Reported by:

KATHY L. SOPER, RPR, CSR
California CSR No. 8519

A-6

August of '81.

MR. HUBBARD: Well, if he was a member of the committee from '81 to present, I presume the committee existed. But I really prefer to depose the witness and not you.

MR. O'KEEFE: That's fine, I am not answering any questions here. I just want to know what time period you are talking about. So we are talking August of 1981 right now.

THE WITNESS: Would you mind repeating the questions, please?

BY MR. HUBBARD:

Q. Yeah. The question was, how did the committee go about determining the reinsurers that were to go on the list to be utilized?

A. Essentially, we examined certain criteria for the purpose of making that determination.

Q. Okay. And what criteria was that?

A. Staff, size, Best rating, NAIC early warning tests. Those are the main bullets.

Mr. O'KEEFE: Is staff a different thing from size or did you mean to say staff size as one criteria? Should there be a

comma between staff and size, for the Reporter's purposes?

THE WITNESS: Yes.

BY MR. HUBBARD:

Q. How about the annual reports or annual statements?

A. Yes, if you mean did we examine them.

Q. Yes, as part of the criteria that you used.

A. Yes.

Q. Okay. If we can sort of break those down and sort of talk about what you wee looking for in the criteria. We can take them in the order.

The staff, what were you looking for when you looked at the staff of these companies?

A. People that worked there that were reasonably experienced in presumed -- the presumption being that they knew what they were doing.

Q. Were your -- was your primary concern there underwriting standards?

A. Yes.

Q. And so you were looking for staff which you thought were -- would

be knowledgeable in implementing good sound underwriting standards?

A. That's right.

Q. Size, what were you looking for in size?

A. Well, in terms of policyholders' surplus, we had varying amounts of a minimum standard for property and casualty reinsurance.

Q. Okay.

Contain ratios.

If you understand the question or would like to have it read back to you, go ahead.

THE WITNESS: Conceivably.

BY MR. HUBBARD:

Q. Conceivably.

A. Well, you were hypothesizing and I am saying that conceivably, yes.

Q. Right. Would you consider reinsurance a very risky part of the insurance market?

A. If you are asking for my personal opinion?

Q. Yes.

A. Yes.

Q. Are there certain ways to artificially increase the policyholder surplus or reflect it by a company?

MR. O'KEEFE: Object on foundation grounds. Object as being beyond the scope of the notice of examination and as calling for expert testimony, and I also object as vague as to what's meant by the term "artificial."

THE WITNESS: Well, that's the term I was going to question. "Artificial" is --

MR. O'KEEFE: Are we talking about fraud of some sort?

THE WITNESS: -- pretty broad. yeah, do

So in the context of having a large number of retrocessionaires and a large amount of sessions, and, therefore, a large amount of receivables, which ties back to your question, I would say that was practiced with -- considerably or frequently and by, presumably, some of the finest security in the world.

BY MR. HUBBARD:

Q. Right.

A. I say presumably because everybody has their opinions about Lloyds.

Q. Sure.

A. So I don't think, in and of itself, you can look at a single portion of an operating statement and say that's bad or that's good.

Q. You don't think that --

A. Furthermore, it wasn't our job.

Q. Okay. Let's take one at a time, if we can. Okay?

A. Okay.

Q. If the - does the Schedule F of the annual statement list the retrocessionaires?

MR. O'KEEFE: Schedule F?

MR. HUBBARD: Right.

THE WITNESS: That's correct.

BY MR. HUBBARD:

want to read things into it.

MR. O'KEEFE: Well, I am going to object, again, as vague. Object for the reasons stated previously, that this present tense question as to what some person in some unstated capacity might want to do in 1991 is beyond the scope of this examination and certainly irrelevant to this litigation.

THE WITNESS: I am not sure that I can give you

a good answer to your question, bill. It's certainly something that I know Best looks into, and I -- but beyond that, I don't know how to answer your question.

BY MR. HUBBARD:

Q. Okay. But as I understand your testimony, that is not something that the market security committee looked into?

A. That is correct.

Q. Okay. Did the market security committee look into the investments of the reinsurance companies on the approved list?

MR. O'KEEFE: And what's the time period?

MR. HUBBARD: 1980-'84.

THE WITNESS: No. A modification to

UNITED STATES DISTRICT COURT

MIDDLE DISTRICT OF TENNESSEE

NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY, by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company,
Plaintiff

Vs

File No. 3-90-0581

E.W. BLANCH CO., E.W. BLANCH, JR., General Partner, MICHAEL W. CASHMAN, SR., General Partner, and FRANK S. WILKINSON, General Partner,
Defendants

DEPOSITION OF

LEO T. HEIFETZ

VOLUME II

August 23, 1991

9:00 a.m.

Reported by:

KATHY L. SOPER, RPR, CSR

California CSR No. 8519

MR. O'KEEFE: And I think the record ought to be clear it was Leo Heifetz talking about himself. Your question was not in the context of what brokers versus ceding companies or --

MR. HUBBARD: Mr. Heifetz can clarify his answers.

MR. O'KEEFE: It was your question, not his answer.

MR. HUBBARD: you can ask clarifying questions after I finish, but it's hard for me to carry on with the continual interruptions.

BY MR. HUBBARD:

Q. Okay. So in 1981 this would not -- Blanch would not have made any inquiry concerning the reinsurance recoverables of Universal Re; is that your testimony?

A. Generally, we would not, correct.

Q. Okay. Even if -- and that's true even if the reinsurance recoverables were 256 percent of the policyholder surplus?

A. That is correct.

Q. Okay. Now, moving over to 1981, the subsidiary is introduced there, which I presume is Bellefonte. The value placed on that subsidiary is 72 percent

MEMO TO: Rennie, Collins, Jamieson, Cashman,
Mavros, Malloy and Frye

RE: Market Committee
Structure/Responsibilities

The following sets for the basic policy for the Market Committee (formally known as Market Security Committee).

A. MEMBERSHIP - Group Heads (except Swager), Wilkinson and Rennie, with Rennie being Chairperson

B. MEETING SCHEDULE - quarterly, in conjunction with Board meetings; more frequently as needed, via memo or telephone.

C. AREAS OF RESPONSIBILITY

1. Establishing financial criteria - the committee shall establish general and specific benchmark plus tests as to financial strength to be applied to reinsurers who wish to qualify as one of our approved markets.

The only specific benchmark is a minimum policyholders' surplus size being $7,500,000 for property markets nd $15,000,000 for casualty. Two qualifications:

- This applies to new markets only; the existing markets are to be grandfathered under our old benchmark of $5,000,000 property and $10,000,000 casualty;

- This does not apply to foreign reinsurers unless policyholders' surplus can be converted to U.S. accounting standards (see Sales and Service Bulletin No. 302 Foreign Marketing for specifics on determining acceptability of foreign reinsurers).

Attached, as Appendix A, is a form which will be completed on all markets that are to be considered for approval or for upgrading. This form includes the most commonly used financial ratio tests,

(e.g., NWP:PHS) as

well as outside information (e.g., NAIC "Early Warning"). Although no specific guidelines are recommended as respects this additional information, it should be used by the Committee in reaching its decision, i.e., the meeting of the policyholders' surplus size requirement should not mean automatic market approval.

2. Approval of new reinsurers - the Committee shall use the guidelines and information described in 1 above to decide upon the status of each new reinsurer that comes before the Committee for approval.

   The Market Committee members will receive from Carol Rennie (assisted by Rich Banyard), prior to each scheduled meeting, information contained in Appendix A for each reinsurer in question; this should give committee members enough time to review the information prior to making a decision.

   If review of a market's status is needed between scheduled committee meetings, then this information will be routed to members so a decision can be reached without the need for a formal meeting.

   A reinsurer's approved market status will be decided by a majority vote of the Committee.

3. Survey of reinsurers' financial strength - an annual survey of the financial strength of all of our currently approved markets will be prepared by Carol Rennie (assisted by Rich Banyard) for review by the Market Committee prior to the second quarterly Board meeting (generally held in June) at which time it will be reviewed.

The purpose is to provide the Committee input to determine whether there should be any change in market status. Such reviews can be done on an individual market basis at any time during the year if a Market Committee member feels that it is warranted due to changes in a reinsurer's financial condition.

This survey will include, for all of our major domestic reinsurers, the following information for the year just ending:

- NWP: PHS;
- Trade Ratios;
- NAIC Early Warning System test results.

In addition, any unusual development (e.g., change in ownership) will be brought forth at that time.

4. Survey of reinsurers' performance - an annual market performance survey will also be prepared by Carol Rennie (assisted by Banyard) for review by the Market Committee at the second quarterly Board meeting. This involves the ranking of approved markets in the following areas:

- Premium volume from our office;
- Profitability of business from our office;
- Accept/Decline ratio of business from our office;
- Promptness of claims payments through our office;
- Brokerage to us from the various markets that are also our retrocessional clients.

This committee previously had only dealt with the financial security of our markets. Its role is now expanded to also include developing overall, as well as specific, marketing strategy. At this meeting of the Committee, it should specifically accomplish the following as respects market strategy:

- Note the markets that have been particularly helpful so that this information can be communicated to our other brokers (e.g., through Sales and Service Bulletin No. 305 - Marketing

Guide) and also to the markets themselves;

- Note the markets where we should be getting better performance (e.g., high declination ratio or slow claims payment) and determine what should be communicated to our brokers and to these markets;

- Determine whether there should be any change in our marketing strategy, either overall or as respects specific reinsurers, the purpose being to maximize placement effectiveness and also to increase the development of retrocessional business.

FSW:jmb Wilkinson
4332H
cc: Blanch, Hitz and Banyard

APPENDIX A

REINSURER ANALYSIS
(For Approved Market Status)

Reinsurer_____
Year_____
Prepared by_____ Date_____

I. FINANCIAL DATA

A. Annual Statement Information

Direct Written Premium	$_____
Net Written Premium	_____
Net Earned Premium	_____
Year End PHS	_____
Year End UEP	_____
Year End O/S Loss	_____
Year End Bonds (@ Amortized)	_____

B. Financial Ratios

NWP : PHS

Loss Reserves :

Trade Ratios	Loss	Expense	Combined
- Latest Year	%	%	%
- Last 5 Years	%	%	%

C. Best's Information

Latest Best's Report Attached _____
Best's Rating ( ) _____

D. Additional Information

NAIC "EWS" Test Attached _____
Stockholders(GAAP) Statement Available

E. W. BLANCHE CO.
Reinsurance Services

8396G-L 9/29/80

II. GENERAL BACKGROUND

A. Chief underwriter & Background*

* IF not widely known

B. Desired Types of Business

C. Gross Line Commitments

D. Retrocessional Protection

E. Description of Ownership

III. UNDERWRITING MANAGEMENT COMPANY (if applicable)

A. Description of Ownership

B. Anniversary Date for issuing

reinsurers _____

C. Audited Financial Statement attached

_____

E. W. BLANCHE CO.
Reinsurance Services

8396G-L 9/29/80

July 31, 1981

SALES AND SERVICE BULLETIN NUMBER 300

SUBJECT: General Procedures on Marketing

GENERAL POLICY

Due to the personal nature of our business, the Blanch Co.'s current policy concerning the marketing of treaty reinsurance is to leave to the discretion of each account team the decision as to which of our approved markets it approaches in the marketing of business.

There are, however, certain reinsurance markets that management wants special consideration given in the offering of business. These are:

1. Retrocessional clients - This is a profitable form of reciprocity that we all should promote. Attached as Appendix A to this Bulletin, is a listing (as of January 1, 1981) of our retrocessional clients or insurance company clients who have a reinsurance company affiliated (e.g., First State); included in this appendix is the anticipated current year's brokerage income to our office; the relative importance of each therefore can be determined. On the marketing list these retro clients are further earmarked by a single asterisk following the company name.

2. Foreign reinsurers - In order to be capable of worldwide marketing, we must provide a reasonable flow of offerings to foreign (meaning non-U.S.) reinsurers. These markets are essential to our success when placing capacity-type programs (e.g., excess catastrophe programs of $15,000,000 or larger) and also in the placing of U. S. Retrocessional business, especially pro rata participations.

3. Special situations - For a variety of reasons, senior management, from time to time, may feel it is in our company's best interest to give favored treatment to a particular reinsurer. Some examples

when this could be applicable:

- A good potential retrocessional client.
- A market that would be more cooperative to difficult areas if it saw a flow of "normal" offerings;

These special situations will be communicated to the account teams at either Sales nd Service meetings or alternatively, via a memo.

The objective of successfully promoting these markets must be met. If any account team accepts this responsibility by making a voluntaty effort, then we will avoid the other alternative of having to establish specific marketing directives.

MARKET COORDINATOR

The coordinator and implementation of the E. W. Blnch Co.'s marketing policy is under the direction of Leo Heifetz with assistance from Rich Banyard. THis involves for Heifetz the following areas of responsibility:

- Chairperson of the Market Commiettee;

- Coordinator for all of our brokers as respects market problems an market information

- Implementation of all corporate policy pertaining to marketing;

- Overall supervision of markets' visits; entertainment, etc.

MARKETING SLIPS

1. Types - In order to offer a reinsurer business, it must first be approved by our Market Committee. Approved markets are set forth on the following marketing slips which are attached as Appendix B to this Bulletin:

Type	Color
Primary	
Property	White
Casualty	Blue
Secondary	
Foreign	Green
NY Ins. Exch.	Buff

If placement requires the use of one or both of the secondary slips, the total foreign and/or NYIE placement should be entered at the bottom of the white or blue marketing slip, which is intended to show the total EWB Co. placement.

2. Confidentiality - Our marketing slips, and especially a reinsurer's status (e.g. whether on the casualty list), should be considered confidential information and specifics should not be discussed with any reinsurer. If a reinsurer is persistent in making such inquiries, then they should be referred to Heifetz.

3. Procedures - The specific procedures as respects completing and subsequent handling of the Marketing Slips are set forth in the Procedures Manual Notebook under Appendix D-8. Appendix D-8, which is due for revision, is somewhat dated but the general procedures contained therein still apply.

Several supplemental comments on the use of Marketing Slips:

- Approved domestic reinsurers are included on the white and/or blue marketing slips. By applying certain criteria, the Market Committee determines whether a potential market is acceptable and, if so, whether it should be on the property (white) list only, or also on the casualty (blue) list.

Because of the long-tail nature of casualty reinsurance, there are more stringent financial criteria for companies to be approved for the blue list.

- Markets approved for LMX only do not appear on the white and blue marketing slips. These are included on a separate LMX marketing slip used by Ronnie Raymond.

- Certain markets, approved for special situations only, do not appear on the marketing slips. There are:

American Medical Assurance	Medical Malpractice
Bituminous Casualty	Financial Reinsurance
Doctors Co.	Medical Malpractice
North American Re	AgRe Facility
Pinnacle (C.E. Health & Co.)	Discounting loss reserves
Retcom Re (Kemper Group)	Discounting loss reserves
SCOR Re	AgRe Facility

- If a reinsurance offering is on a multiple line basis, then the casualty list should be used unless the casualty exposure is incidental in comparison to the property. An example where the property list would be acceptable in a multiple line situation, would be a combination excess catastrophe and clash casualty with the latter producing only nominal exposure.

- Reinsurers assuming business through management companies are listed under the name of the management company. In cases where the manager writes for a large number of reinsurers, e.g. MRB, the names of the individual pool members are omitted. If the manager writes for one reinsurer, or writes separate lines for a small number of reinsurers, the assuming reinsurers are listed below the names of the management company.

- On the property and casualty marketing lists, companies which have a single asterisk (*) are retrocessional clients

and, as set forth in the General Policy section of this Bulletin, should be favored.

- On property and casualty lists, companies which have a double asterisk (**) are known as protected markets. They have been so classified because a) they are clients, b) the bulk of their assumed reinsurance is accepted through our office and c) they don't employ a full time reinsurance underwriter. "Protected" means that you must consult with the servicing broker responsible for the company's ceded reinsurance program before submitting any new offer to one of these companies.

Our current protected reinsurance markets are:

Company	Servicing Broker
Alabama Farm Bureau	Frye
Doctors Co.	Jamieson
Horizon Underwriters	O'Brien
Imperial Casualty & Indemnity	Armstrong

Company	Servicing Broker
Republic Insurance	Cashman
United Fire & Casualty	B. Anderson
Western National	McMorrow

- The foreign marketing list (green) includes all non-U.S. markets (including London, Canada and Bermuda). To distinguish reinsurers for property only, a # follows the company's name; all other companies can entertain both property and casualty. The total foreign placement should be indicated on the white or blue marketing slip under "Foreign". For specific procedures on placement with foreign markets, please refer to Sales and Service Bulletin

No. 302.

- New York Insurance Exchange syndicates are individually reviewed by the Market Committee. Syndicates approved by the Committee are listed on the buff-colored marketing slip. Those marked with a # are approved for Property business only. As is the case with foreign placements, the total Exchange placement should be indicated on the white or blue marketing slip under the entry "New York Insurance Exchange."

NEW YORK INSURANCE EXCHANGE

To facilitate greater uniformity and control over placements being submitted to the New York Insurance Exchange, the following procedures should be implemented on all future placements.

Regarding New Placements:

1. One copy of the submission should be forwarded to Peter Zurfluh's attention, along with any special instructions and the appropriate percentage which can be allocated to the New York Insurance Exchange.

2. While our New York placing broker (e.g. Zurfluh, Olson, et al) will answer any general questions, he will suggest that any detailed inquiries of the underwriter be directed back to the responsible AEA.

3. The account team's AEA will be advised of the status of placements, each Friday.

4. Upon completion of each placement, a schedule listing the participating Syndicates with their percentage authorization and a contact person, will be forwarded to the AEA.

5. If a contract is oversubscribed, a joint effort should be made to sign all Reinsurers down evenly. Our objective is to avoid signing down the New York Insurance Exchange alone.

6. Once a placement has been finalized, the New York office should be advised so that a New York Insurance Exchange abstract can be completed with each Syndicate's signed line. A New York Insurance Exchange reference number will be assigned at this time, which should be utilized in any subsequent correspondence with the Exchange.

Regarding Renewals:

1. If no additional capacity is needed, renewal letters should be forwarded directly to each Syndicate with a blank copy to the New York office for their records. Otherwise fully addressed proposals, plus one blank copy, can be sent to the New York office for distribution.

2. Once the placement has been finalized, the New York office should be advised and the New York Insurance Exchange abstract will be procured from the Syndicate members.

3. Confirmation letters are the responsibility of each account team.

Regarding Contract Wording:

1. One copy of the wording and two copies of the I & L's should be forwarded to the New York Insurance Exchange, 59 John St., New York, N.Y. 10038. Attn: Dawn Adams or Truman Dodson. They will obtain each Syndicate's approval of the wording and execution of the I & L's, before returning one copy of the I & L's to the appropriate AEA.

2. "Schedule B" should be typed on the front page of all wording being submitted to the Exchange.

Routing Correspondence:

All general correspondence and minor contractual changes are the responsibility of the AEA and not the New York office.

REINSURER FINANCIAL DATA

A file containing financial data on reinsurers, except those through corresponding brokers, is kept by Lorraine Mueller. For domestic reinsurers, this file includes NAIC Early Warning Test results (when available) and our Performance Analysis of the Annual Statement. For foreign reinsurers, there is a one-page summary of the financial statement.

The main purpose of accumulating these data is to have summarized financials of our reinsurers available to provide our clients. We expect to get an increase in such requests due to the new auditing guidelines that are being adopted by the AICPA; these pertain to a company's procedure in reviewing the financial strength of its reinsurers.

When one of our servicing brokers receives such a request, our procedure is to notify Heifetz, who will send the requested information to the client with a cover letter similar to the one set forth in Appendix C. The reason for centralizing this procedure is two fold:

- to insure the message gets across that the final decision on reinsurers' acceptability rests with the clients; and

- to be able to judge how extensively our clients are requesting such information.

When we receive requests for data on foreign markets placed by corresponding brokers, Heifetz, in turn, will request the information from the corresponding broker on a case-b-case basis unless we have the

information available in file or in a reference source.

CHANGES IN APPROVED REINSURERS

1. Our Marketing Lists contain reinsurers that we feel offer good security. However, as mentioned, the final decision as to the markets is always with the client. If the client does not want one of our approved reinsurers, for whatever reason, then this reinsurer should be replaced.

   Under Appendix D-2 of our Procedures Manual, there are instructions as to the proper wording regarding market acceptability in a confirmation letter to a client. As set forth in point 4 of Appendix D-2, always include in such a latter the following:

   > "These reinsurers appear to be financially sound and offer good security; however, we do want you to review this list, and should you have any questions or comments about any of them, please let us know. Otherwise, we will assume they are acceptable and we will proceed with final confirmation and documentation."

   This is necessary in order to put the responsibility for final approval of markets with the client.

2. There also may be the reverse situation to the above, i.e., a client may want to have a reinsurer participate which is not on our approved list or not approved for the class of business under consideration. This generally arises under two circumstances:

   - For personal, or whatever reason, a client may request a specific market be offered his business;

- If there is difficulty in completion, the use of other than an approved market may be the only alternative to having an unfinished cover.

Under such circumstances, the reinsurer that is not on our approved Marketing List cannot be used without first notifying Heifetz and then documenting such notification in the treaty file.

The use of nonapproved markets is a delicate situation. The following is the recommended procedure:

- Verbally discuss with the client, the particular reinsurer, explaining why such market is not on the applicable Marketing list (this is to be done after conferring with Heifetz, as set forth above).

- Assuming our client still wants to use the market, then proceed with written confirmation to the client along the following line:

"During recent conversations we pointed out exceptional facts regarding certain of these reinsurers; however, we do want you to review this list and, should you have any questions or comments or wish to make any changes, please advise immediately. Otherwise, we would appreciate your approval of the reinsurers by writing us a latter or telex to that effect. After receipt of your approval, we will proceed with final confirmation and documentation."

3. When writing to the client confirming the reinsurers, either provide a complete list of reinsurers (plus percentages) or the specific changes in reinsurers. If we handle a total program involving a number of contracts, then, in addition to the specific confirmation letter, a master exhibit setting forth the different contracts and percentage participations should be prepared for the client: See Appendix D for an example.

4. When confirming a participation authorized by a reinsurance pool or underwriting management company, the reinsurers behind the pool or management company should also be specifically set forth. Notebooks containing the lists of participants in these management companies' pools are available from Lorraine Mueller and from the office manager in each branch office. When these lists are updated, Rich Banyard will send copies of the updated lists to each branch office.

   Some management companies underwrite for facilities in which the percentage share of each reinsurer is fixed (e.g., MRB). Others have discretion as to how large a line to write for each of their issuing companies, (e.g., Boston Re). if a management company has such flexibility, always be sure to indicate what portion of its line is placed with each individual issuing reinsurer. Also, if the subject business is Casualty, check to see if each issuing reinsurer is approved for Casualty. In the case of Boston Re, for example, New Zealand and General Accident are approved for Casualty, but RLI is not.

5. The Marketing Lists are periodically reviewed and updated by the Market Committee; this can result in deletions and/or additions. All such changes made by the Market Committee will be communicated in writing to Sales and Service personnel, usually accompanied by new Marketing Slips. If there is a deletion of a market from one of the Slips, the memo will specify whether such deletion applies only to new offerings or whether it would apply to existing business as well (i.e., whether the reinsurer must be replaced on in force contracts at first opportunity). The memo will also communicate any underwriting or policy changes or our approved markets that should be generally known. The market memo and updated marketing slips will be issued quarterly (more often, when necessary).

Attachments

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY
by and through DAVID S. WEED,
Special Deputy Commissioner
of Commerce and Insurance for
the Rehabilitation of Cherokee
Insurance Company,

Plaintiff

vs.

E.W. BLANCH CO., E.W. BLANCH,
JR., General Partner, MICHAEL
W. CASHMAN, SR., General Partner,
and FRANK S. WILKINSON, General
Partner,

Defendant

Court File No. 3-90-0581
Judge Echols/Magistrate Hayes

SECOND AFFIDAVIT

OF

LEO T. HEIFETZ

Leo T. Heifetz, being first duly sworn, upon oath deposes and states as follows:

A-6

1. I am a Senior Vice President at W. E. Blanch Co. ("Blanch"), 300 West 80th Street, Minneapolis, Minnesota. I have personal knowledge of the facts set forth below.

2. In August of 1991, I had my deposition taken in this action. At that time, I described my involvement with the Market Security Committee at Blanch. I was the chairperson of that committee throughout the 1981 to 1984 time period.

3. The Market Security Committee developed an "approved market" list, which identified for internal purposes the reinsurers that Blanch brokers could consider proposing to ceding companies. Among the criteria used by the Market Security Committee in developing the approved list was the financial strength of the reinsurers. In determining the financial strength of reinsurers, the Committee looked at a variety of factors. These factors or criteria included the size of the company (its policyholder surplus); the rating given to the company by A. M. Best Company, as well as the Best narrative report on the company; the commitment of the company's ownership to the business; the National Association of Insurance Commissioners (NAIC) early warning or IRIS test results; the quality and experience of the reinsurer's personnel; and an

analysis of the reinsurer's annual financial statements, including use of a variety of trade ratios.

4. In conducting this review of the financial strength of reinsurers, the Committee, and Blanch personnel assisting the Committee, prepared certain forms setting forth data relating to reinsurers. Attached hereto as Exhibits A-C are copies of various forms used by the Market Security Committee to record information concerning reinsurers. Exhibit A, entitled "Reinsurer Analysis", was used at least during the 1980-1982 time period. Exhibit B, entitled "Reinsurer Annual Statement Financial Data", was used during the 1982-1984 time period. Exhibit C, also entitled "Reinsurer Annual Statement Financial Data", was used at least in analyzing 1984 financial data.

5. I have reviewed the document entitled "Reinsurance Security", which is Exhibit I to the Affidavit of Brenner VanMeter, and which purports to be a document prepared by Guy Carpenter Company, Inc, dated January 1, 1983. I have never seen this document before being provided a copy by Blanch's counsel, and I cannot authenticate whether it is what it purports to be. I have reviewed the documents, however, to compare the review of reinsurers allegedly conducted by Guy

Carpenter as described in that document with the review done by the Blanch Market Security Committee during the 1981 to 1984 time period. The factors identified in the alleged Guy Carpenter document are similar if not identical in most respects to information reviewed by the Blanch Market Security Committee, and the Blanch Market Security Committee also considered additional information not identified in that document.

6. Page 1 of the alleged Guy Carpenter document indicates that Guy Carpenter utilized reinsurers with minimum policyholder surplus of $10,000,000 for property business and $20,000,000 for other reinsurance. Blanch had similar minimum policyholder surplus criteria during the 1981-1984 time period. The reinsurers involved in the present case, Mission, Transit, and Mutual Fire, all had a policyholder surplus well in excess of $20,000,000 at the time of each placement and renewal. The alleged Guy Carpenter document also indicates that Guy Carpenter normally required a Best's Rating of "A" or better. Each of the reinsurers involved in the present litigation had a Best's Rating of "A" or better at each placement or renewal.

7. On the second page of the alleged Guy Carpenter document, the document states that Guy Carpenter's Market Security Committee

considered 12 "points" when reviewing each market or reinsurer. These points are similar or identical to factors also considered by the Blanch Market Security Committee, as described below:

a. Point 1 is the size of the reinsurer in terms of policyholder surplus or equivalent net worth. Blanch too looked at policyholder surplus ("PHS"), as indicated above and as reflected in Exhibit A-C.

B. Point 2 is the volume of premiums written relation to net resources. This ratio is the same as ratio No. 1 of the Early Warning System("EWS") or IRIS tests used by the National Association of Insurance Commissioners (NAIC), which Blanch used in reviewing reinsurers, as reflected in Exhibit A.

C. Point 3 is the amount of reserves for losses, loss adjustment expense, and unearned premium, in relation to net resources and net premiums. This information also was reviewed by the Blanch Market Security Committee, as reflected in part VI of Exhibits B and C.

D. The fourth point is underwriting performance and trends.

The IRIS or Early Warning System test No. 4, which was considered by Blanch, was a test of underwriting performance and trends. Moreover, Exhibits A-C identified underwriting performance and trends of the reinsurer.

E. The fifth point is mix of business. The narrative report published by A.M. Best Company, which was reviewed by the Market Security committee, described the mix of business of companies such as Mission, Mutual Fire, and Transit. Moreover, as reflected in Exhibit A, the Committee took note of the reinsurer's desired types of business and gross line commitments.

F. Point 6 is loss reserve development trends. IRIS test Nos. 9-11 tested loss reserve development trends and were used by Blanch. For example, Exhibit A set forth the loss ratios for the past five years. Exhibits B and C similarly provided three-year historical data on loss development.

G. Point 7 is investment portfolio with respect to liquidity,

diversification and maturity. IRIS test No. 7, used by the Blanch Market Security Committee, was designed to test the reinsurer's investment portfolio. Moreover, as reflected in Exhibits B and C, the Blanch Market Security Committee reviewed the extent to which assets of the reinsurer were in cash, bonds, stock in subsidiaries, and other stock.

H. Point 8 is investment income in relation to gross premiums. This is the same as IRIS test No. 4, relied upon by Blanch, and also is information recorded in Exhibit B, part IV.

I. Point 9 is analysis of cash flow of operations. The alleged Guy Carpenter document does not describe the type of cash flow analysis contemplated. Exhibit B sets forth changes from the prior year to the current year with respect to cash and other assets and liabilities of the reinsurer.

J. Point 10 is loss paying margin, the ability of the company to absorb an unusual shock. As reflected in

Exhibit C, Blanch in analyzing 1984 financial data included a separate section on loss paying margin. Prior to that time, Blanch reviewed information that reflected the ability of a company to absorb an unusual loss, as reflected in Exhibit B, such as the company's assets, and its net worth or policyholder surplus.

K. Point 11 indicates that Guy Carpenter purportedly analyzed underwriting and investment result trends over the prior five years. The Blanch Market Security Committee in assessing reinsurers also reviewed the companies' trends over multiple year periods. For example, as reflected in Exhibit A, Blanch reviewed the reinsurer's loss and expense trends over the preceding five years. Similarly, as reflected in Exhibit B, the Committee analyzed a variety of trends over a three-year period of time, including changes in policyholder surplus, changes in a number of trade results, and loss development trends.

L. Point 12 is a review of management's record and

reputation in the industry and the extent of the company's commitment to the reinsurance business. These too were factors considered by the Blanch Market Security Committee. The information is recorded in the A. M. Best Company Narrative Report, and also was recorded to some extent in Exhibit A, page 2. Blanch also attempted to keep records of the extent to which reinsurers accepted or declined business, which reflected their commitment to the reinsurance business. The Committee also obtained input from its brokers and trade publications to assess the companies' record and reputation in the industry.

M. In addition to the 12 points listed on page 2 of the alleged Guy Carpenter document, the document also indicated that Guy Carpenter allegedly ascertained reinsurance underwriting philosophy and capacity, classes of business, and retrocessional arrangements. As reflected on the second page of Exhibit A, this also was information reviewed by the Blanch Market Security

Committee.

8. In reviewing the information similar to that set forth in the alleged Guy Carpenter document, as well as the other information identified in Exhibits A-C, the Blanch Market Security Committee determined that Mission, Transit and Mutual Fire should be included on Blanch's approved list. I am not aware of any other reinsurance broker, including Guy Carpenter, that excluded these companies from their approved lists during the 1980-1984 time period.

9. Although Blanch internally conducted the review described above and reflected in Exhibits A-C in developing its approved list of reinsurers, Blanch and the industry in general also relied heavily upon state insurance regulators and the A. M. Best Company to analyze and determine the financial strength of reinsurers. The various state insurance regulators and A. M. Best Company conducted, or were understood by Blanch and other industry members to have conducted, an in depth review of the financial condition of insurance companies, including Mission, Transit and Mutual Fire, which review would have included an analysis of the factors set forth in the alleged Guy Carpenter document. Blanch understood that the analyses done by A.M. Best

Company and state regulators was much more detailed and authoritative than the reviews done either by Blanch or allegedly done by Guy Carpenter, and Blanch, as did the rest of the industry, relied heavily upon the results of the analyses of A.M. Best Company and state regulators, supplemented by Blanch's own review of reinsurers. During the 1980-84 time period, both A.M. Best Company and the state regulators reported that Mission, Transit, and Mutual Fire were viable companies.

10. Cherokee's expert, Mr. Bernard Webb, purports to have developed a test for predicting the failure of insurance companies, and apparently claims that Blanch was negligent in not using that test during the 1980-1984 time period. Based on my many years in the insurance and reinsurance industry, I am unaware of that test ever being recognized within the industry as a valid predictor of insurance company insolvencies.

Moreover, in order to test the validity of the Webb financial ratios as a predictor of insolvencies, Blanch personnel under my supervision ran those ratios on the nearly 2000 insurance companies on the Blanch computer data base, for which Blanch possesses year 1984 financial data. Those nearly 2000 companies include 20

property/casualty insurance companies that became insolvent after 1984. We determined that the Webb ratios were not a valid indicator of insolvencies.

For example, we found that nearly one-half of the companies, or 984 of the total of 1989 companies, failed one or more of the six Webb ratios. Of those 984 companies, only 14, or less than two percent, subsequently went insolvent. Six, or 30%, of the twenty insolvent companies passed all six Webb ratios. The 970 solvent companies that failed one or more of Webb's ratios included many prominent and sound insurance companies, such as St. Paul, Cigna, Hartford, Aetna, and Crum and Forster insurance companies, and also included many of the best reinsurance companies, such as Kemper Re and Constitution Re.

We also tested whether any one of the six Webb ratios appeared to be valid predictors of insovlencies. None of them do. Ratio #1 predicted the insolvency of only 4 of the 20 insolvent companies, and predicted the insolvency of 142 companies that remained solvent. Ratio #3 predicted the insolvency of only 4 of the 20 insolvent companies, and predicted the insolvency of 534 companies that remained solvent. Ratio #4 predicted the insolvency of only 50 of the 20 insolvent companies,

and predicted the insolvency of 349 companies that remained solvent. Ratio #5 predicted the insolvency of only 10 of the 20 insolvent companies, and predicted the insolvency of 645 companies that remained solvent. Finally, Ratio #6 predicted the insolvency of only 8 of the 20 insolvent companies and predicted the insolvency of 588 companies that remained solvent.

Based on the above data, it seems clear to me that the Webb test has no validity as a predictor of future insolvencies. Had the test been available to me in 1980-84, which it was not, as chair of the Blanch Market Security Committee I would not have considered it prudent to use the test to assess reinsurers.

FURTHER AFFIANT SAITH NOT.

S/Leo T. Heifetz
Leo T. Heifetz

Subscribed and sworn to before me
this 8th day of September, 1992.

/S/Kathleen C. McGinnis
Notary Public

APPENDIX A

REINSURER ANALYSIS

(For Approved Market Status)

Reinsurer_____

Year_____

Prepared by_____Date_____

I. FINANCIAL DATA

A. Annual Statement Information

Direct Written Premium	$_____
Net Written Premium	_____
Net Earned Premium	_____
Year End PHS	_____
Year End UEP	_____
Year End O/S Loss	_____
Year End Bonds (@ Amortized)	_____

B. Financial Ratios

NWP : PHS

Loss Reserves : PHS

Trade Ratios	Loss	Expense	Combined
· Latest Year	%	%	%
· Last 5 Years	%	%	%

C. Best's Information

Latest Best's Report Attached _____

Best's Rating ( ) _____

D. Additional Information

NAIC "EWS" Test Attached _____
Stockholders(GAAP) Statement Available

II. GENERAL BACKGROUND

A. Chief Underwriter & Background*

* IF not widely known

B. Desired Types of Business

C. Gross Line Commitments

D. Retrocessional Protection

E. Description of Ownership

III. UNDERWRITING MANAGEMENT COMPANY (if applicable)

A. Description of Ownership

B. Anniversary Date for issuing reinsurers _____

C. Audited Financial Statement attached

_____

August 2, 1982

REINSURER ANNUAL STATEMENT
FINANCIAL DATA

PREPARED BY E.W. BLANCH CO
(ALL FIGURES IN THOUSAND DOLLARS)

COMPANY: CHEROKEE INS CO
YEAR: 1981

I. BALANCE SHEET DATA (STATUTORY)

	CURRENT YEAR	PRIOR YEAR
A. ASSETS		
1. CASH	364	347
2. BONDS	17,730	12,265
3. STOCK-SUBSIDIARIES	0	0
4. STOCK - ALL OTHER	581	5,242
5. ALL OTHER ASSETS	6,149	5,534
6. TOTAL ASSETS	24,824	23,388
B. LIABILITIES		
1. O/S LOSS & LOSS EXPENSE	7,233	7,149
2. UNEARNED PREMIUM	7,718	7,907
3. ALL OTHER LIABILITIES	2,516	2,304
4. TOTAL LIABILITIES	17,467	17,360

II. PREMIUM

A.	DIRECT WRITTEN PREMIUM	19,278	18,056
B.	ASSUMED WRITTEN PREMIUM	7,367	8,071
C.	CEDED WRITTEN PREMIUM	13,679	12,277
D.	NET WRITTEN PREMIUM (A)-(B)-(C)	12,966	13,851

REINSURER ANNUAL STATE - FINANCIAL DATA
COMPANY: CHEROKEE INS CO

III.	PROFIT (STATUTORY)		
	A.	NET EARNED PREMIUM	13,15413,408
	B.	LOSSES & LAE INCURRED	10,56311,600
	C.	UND. EXP. INCURRED	4,9585,328
	C.	STATUTORY PROFIT (A)-(B)-(C)	-2,367-3,519
IV.	GAIN OR LOSS IN PHS (STATUTORY)		
	A.	PHS - PRIOR YEAR	6,028
	B.	NET UNDERWRITING GAIN/LOSS	-2,367
	C.	NET INVESTMENT GAIN OR LOSS	3,727
	D.	OTHER INCOME LESS P.H. DIV.	0
	E.	TOTAL INCOME-(B)+(C)+(D)	1,360
	F.	INCOME TAX	275
	G.	NET INCOME (E) - (F)	1,086
	H.	UNREALIZED CAPITAL GAIN/LOSS	-2,017
	I.	SCHEDULE P CHANGE	0
	J.	DIVIDENDS TO STOCKHOLDERS	0

K.	CAPITAL & SURPLUS CHANGES	2,000
L.	ALL OTHER CHANGES	260
M.	PHS - CURRENT YEAR	7,357

REINSURER ANNUAL STATEMENT - FINANCIAL DATA
COMPANY: CHEROKEE INS CO

V. THREE YEAR HISTORICAL DATA

YEAR	1981	1989	1979
A. CHANGE IN PHS FOR THE YEAR			1,329-508
1,143			
B. RATIOS			
1. UNDERWRITING EXPENSES TO NET PREM. WRITTEN			38.2%
38.5%	37.9%		
2. LOSS & LAE TO NET EARNED PREMIUM			80.3%
86.5%	58.7%		
3. COMBINED TRADE RATIO (1) +(2)			118.5%
125.0%	96.6%		
4. NET WRITTEN PREMIUM TO PHS			1.762.30
1.96			
C. ONE YEAR LOSS DEVELOPMENT*			
1. DEVELOPMENT OF LOSS & LAE			7912,533
1,034			
2. RATIO OF DEVELOPMENT OF LOSS & LAE PHS			

OF PREVIOUS YEAR END 13.1%
38.8% 19.2%

D. TWO YEAR LOSS DEVELOPMENT*

1. DEVELOPMENT OF
LOSS & LAE 3,0422,092
806

2. RATIO OF DEVELOPMENT
OF LOSS & LAE TO PHS
OF PREVIOUS YEAR END 50.5%
32.0% 15.0%

		CURRENT YEAR	PRIOR YEAR
VI.	RATIO OF LOSS RESERVES TO PHS		
	1. POLICYHOLDERS SURPLUS	7,357	6,028
	2. OUTSTANDING LOSS & LOSS EXPENSE	7,233	7,249
	3. RATIO (2)- :(1)	0.98	1.19

05/06/85

REINSURER ANNUAL STATEMENT
FINANCIAL DATA

PREPARED BY E. W. BLANCH CO
(ALL FIGURES IN THOUSAND DOLLARS)

COMPANY: CONSTITUTION REINSURANCE CORPORATION

YEAR: 1984

I. BALANCE SHEET DATA (STATUTORY)

	CURRENT YEAR	PREVIOUS YEAR
A. ASSETS		
1. CASH & SHORT TERM INVESTMENTS	27,433	11,405
2. BONDS	148,534	139,099
3. STOCK-SUBSIDIARIES	0	0
4. STOCK-ALL OTHER	21,424	24,684
5. ALL OTHER ASSETS	7,200	21,957
6. TOTAL ASSETS	204,596	197,145
B. LIABILITIES		
1. O/S LOSS & LOSS EXPENSE	90,918	82,708
2. UNEARNED PREMIUM	49,612	46,435
3. ALL OTHER LIABILITIES	(1,669)	14,060

	4. TOTAL LIABILITIES	138,861	143,203
II.	PREMIUM		
	A. DIRECT WRITTEN PREMIUM	0	0
	B. ASSUMED WRITTEN PREMIUM	235,974	199,293
	C. CEDED WRITTEN PREMIUM	104,735	76,489
	D. NET WRITTEN PREMIUM (A)+(B)-(C)	131,239	123,805

REINSURER ANNUAL STATEMENT FINANCIAL DATA
COMPANY: CONSTITUTION REINSURANCE CORPORATION

III.	PROFIT (STATUTORY)	CURRENT YEAR	PREVIOUS YEAR
	A. NET EARNED PREMIUM	128,063	132,076
	B. LOSSES AND LAE INCURRED	109,658	103,276
	C. UND. EXP. INCURRED	41,946	38,934
	D. STATUTORY PROFIT (A)-(B)-(C)	(23,541)	(10,133)
IV.	GAIN OR LOSS IN PHS (STATUTORY)		
	A. PHS - PRIOR YEAR		53,943
	B. NET UNDERWRITING GAIN OR LOSS		(23,541)

C.	NET INVESTMENT GAIN OR LOSS		21,732
D.	OTHER INCOME		923
E.	TOTAL INCOME (B)+(C)+(D)		(886)
F.	DIVIDEND TO POLICYHOLDERS		0
G.	NET INCOME AFTER DIVIDENDS (E)-(F)	(886)	
H.	INCOME TAX		(324)
I.	NET INCOME (G)-(H)		(561)
J.	UNREALIZED CAPITAL GAIN OR LOSS		(1,987)
K.	SCHEDULE P CHANGE		0
L.	DIVIDEND TO STOCKHOLDERS		0
M.	CAPITAL & SURPLUS CHANGES		15,000
*N.	ALL OTHER CHANGES		(659)
O.	PHS - CURRENT YEAR		65,734

*TOTAL OF ALL OTHER ITEMS AFFECTING SURPLUS IF ANY

REINSURER ANNUAL STATEMENT FINANCIAL DATA
COMPANY: CONSTITUTION REINSURANCE CORPORATION

V. THREE YEAR HISTORICAL DATA

YEAR	1984	1983	1982	
A. CHANGE IN PHS FOR YEAR		11,792	3,728	5,105
B. RATIOS				
*1. UNDERWRITING EXPENSES TO NET PREM. WRITTEN		32.0%	31.7%	23.7%
2. LOSS & LAE TO NET EARNED PREMIUM		85.6%	78.2%	83.4%
3. COMBINED TRADE RATIO (1)+(2)		117.6%	109.9%	117.1%
4. NET WRITTEN PREMIUM TO PHS		2.00	2.28	2.59
C. ONE YEAR LOSS DEVELOPMENT**				
1. DEVELOPMENT OF LOSS & LAE		4,305	(797)	147
2. RATIO OF DEVELOPMENT OF LOSS & LAE TO PHS OF PREVIOUS YEAR END		8.0%	-1.6%	0.3%
D. TWO YEAR LOSS DEVELOPMENT**				
1. DEVELOPMENT OF				

	LOSS & LAE	2,102	(525)	2,447
2.	RATIO OF DEVELOPMENT OF LOSS & LAE TO PHS OF 2ND PREVIOUS YEAR END	4.2%	-1.2%	6.7%

*THE UNDERWRITING EXPENSE RATIO IS CALCULATED AS PER THE METHOD FOLLOWED BY A.M. BEST CO. THESE FIGURES MAY DIFFER FROM THOSE SHOWN ON LINE 57 OF PAGE 21 IN THE COMPANY'S ANNUAL STATEMENT.

**INCLUDES DEVELOPMENT TAKEN FROM BOTH SCHEDULE O AND P. A NEGATIVE FIGURE INDICATES FAVORABLE DEVELOPMENT.

REINSURER ANNUAL STATEMENT FINANCIAL DATA
COMPANY: CONSTITUTION REINSURANCE CORPORATION

		CURRENT YEAR	PREVIOUS YEAR
VI.	RATIO OF LOSS RESERVES TO PHS		
	A. POLICYHOLDERS SURPLUS	65,734	53,943
	B. OUTSTANDING LOSS AND LOSS EXPENSE	90,918	82,708
	C. RATION (B) : (A)	1.38	1.53
VII.	LIQUIDITY ANALYSIS		
	A. LIQUID ASSETS*	201,299	178,688
	B. TOTAL LIABILITIES	138,861	143,203
	C. RATIO (B) : (A)	0.69	0.80
VIII.	CASH FLOW ANALYSIS		
	A. LIQUID ASSETS*	201,299	178,688
	B. NET FUNDS **		
	1. NET FUNDS FROM OPERATIONS	8,295	(20,895)
	2. OTHER FUNDS APPLIED	0	0
	3. TOTAL (1)-(2)	8,295	(20,895)

C. RATION (B) : (A) 4.12%
11.69%

* LIQUID ASSETS AS DEFINED IN RATIO NO. 7 OF EARLY WARNING TESTS.

**DOES NOT INCLUDE CASH FLOW ANALYSIS OF INVESTMENTS. (SEE PAGE 5 OF ANNUAL STATEMENT)

REINSURER ANNUAL STATEMENT FINANCIAL DATA
COMPANY: CONSTITUTION REINSURANCE CORPORATION

IX. LOSS PAYING MARGIN

A. LOSSES INURED TO PREMIUMS EARNED

02.41%

B. UNDERWRITING EXPENSES INCURRED TO PREMIUMS WRITTEN

32.46%

C.	POLICYHOLDERS DIVIDENDS TO PREMIUMS EARNED	0.00%
D.	COMBINED UNDERWRITING RATIO (A+B+C)	114.87%
E.	INDICATED PROFIT OR LOSS (100 - D)	-14.87%
F.	EQUITY ALLOWED IN UNEARNED PREM. (PERCENT)	9.38%
G.	PREMIUM EARNED	128,063
H.	AVERAGE ANNUAL UNDERWRITING PROFIT/LOSS	(19,044)
I.	AVERAGE ANNUAL LOSS FACTOR	52,767
J.	UNEARNED PREMIUM	49,612
K.	EQUITY ALLOWED IN UNEARNED PREMIUM	4,640
L.	POTENTIAL LOSS LIABILITY (J - K)	44,972
M.	LOSS & LAE RESERVES	90,915
N.	LOADING FACTOR (25%)	22,730

O.	POLICYHOLDERS SURPLUS		65,734
P.	UNAUTHORIZED REINSURANCE		694
Q.	EXCESS SCHEDULE P RESERVES		0
R.	EQUITY IN UNEARNED PREMIUMS		4,640
S.	FINANCIAL RATING FACTOR (O + P+ Q + R)	71,068	
T.	LOSS PAYING MARGIN (S - N)		48,338
U.	ADJUSTED LOSS PAYING MARGIN (T + H)	29,294	
V.	ADJ. LOSS PAYING MARGIN/EST. LOSS FACTOR	53.52%	

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY,) by and through DAVID S. WEED,) Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee, Plaintiff,	)
	) Civil Action
	) No.3-90-0581
v.	) Judge Echols
E.W. BLANCH CO., E.W. BLANCH, General Partner, MICHAEL W. CASHMAN, SR., General Partner, FRANK S. WILKINSON, General Partner, and PAUL S. MAVROS, General Partner, Defendants.	)

AFFIDAVIT OF W. LOCKWOOD BURT

W. Lockwood Burt, being duly sworn, deposes and says as follows:

1. I am currently President of Ormond Re Group, Inc. ("Ormond Re") located at 140 South Atlantic Avenue, Ormond Beach, Florida

A-6

32175-2574. Ormond Re was founded in 1960 and I have been with Ormond Re since 1974. Since inception, Ormond Re has been an active participant in the reinsurance industry. It's subsidiary and affiliated companies included a professional reinsurance company (1976 - 1986), and still include today a reinsurance intermediary and several reinsurance underwriting management companies.

2. From 1982 - 1983, I was the chairman of Independent Reinsurance Underwriters ("IRU"), a trade organization comprised of approximately 100 reinsurance markets all of which utilized the services of brokers/intermediaries. As chairman of IRU, I was able to witness the emphasis being placed on security analysis by reinsurance brokers/intermediaries when planning reinsurance. For example, in early 1983 at an IRU meeting, I attended a presentation by Richard Smith, the then vice-president of Guy Carpenter, on reinsurance security. See letter attached hereto as Exhibit A. Also during this time I was very close to the activities and the decisions being made by the AICPA (American Institute of Certified Public Accountants) regarding reinsurance security.

3. On February 28, 1983, Guy Carpenter sent a letter to me enclosing a published statement of the Reinsurance Auditing and

Accounting Task Force of the AICPA and a memorandum on Reinsurance Security prepared by Guy Carpenter. The letter and enclosures are attached hereto as Exhibit B. The letter was sent to me in my capacity as president of W. J. Burt Management, Inc., a wholly owned subsidiary of Ormond Re, and the underwriting manager for the First New York Syndicate Corporation. At that time, First New York Syndicate Corporation purchased its catastrophic reinsurance through Guy Carpenter. Given the tone of the letter, it seems the letter most likely was sent to all of Guy Carpenter's clients and/or their underwriting managers.

4. The letter, coupled with the presentation made by Richard Smith, exemplified the importance Guy Carpenter, as a reinsurance broker/intermediary, placed on the need for security analysis by reinsurance brokers/intermediaries.

FURTHER AFFIANT SAITH NOT.

/S/W. Lockwood Burt
W. LOCKWOOD BURT

STATE OF FLORIDA

COUNTY OF VOLUSIA

SUBSCRIBED AND SWORN to before me by W. LOCKWOOD BURT on this the 24 day of September, 1992.

S/Martha W. Bailey
Notary Public
My commission expires ?/28/94
March 10, 1983

Mr. Richard Smith
Vice President
Guy Carpenter & Co., Inc.
110 William Street
New York, NY 10038

Dear Dick:

On behalf of the Independent Reinsurance Underwriters, I would like to thank you very much for the presentation that you gave at our recent meeting in Florida. I know that all of our members found your remarks to be very informative.

I would also like to compliment on the straight-forward manner in which you outlined Guy carpenter's position on reinsurance security. In light of the AICPA position paper and the current status of our industry, I think that this frank discussion of reinsurance security is long overdue and will ultimately benefit all parties to the reinsurance transaction.

Again, thanks for the time and effort that you spent in attending our meeting and making your presentation.

Sincerely,

W. Lockwood Burt
Chairman/IRU

WLB:mb

GUY CARPENTER & COMPANY, INC.
REINSURANCE
110 WILLIAM STREET
NEW YORK, N.Y. 10038
CABLE ADDRESS "GUYCARP" TELEPHONE(212)701-8500

February 28, 1983

Mr. W. Lockwood Burt,
Executive Vice President
The First New York Syndicate Corporation
c/o Ormond Reinsurance Company
140 Atlantic Avenue
P.O. Box 2574
Ormond Beach, Florida 23074

Reinsurance Security

Dear Lock:

The critical issue of reinsurance security has been subject of late to increasing scrutiny from a variety of sources including the American Institute of Certified Public Accountants (AICPA).

Recently, the Reinsurance Auditing and Accounting Task Force of the AICPA published a Statement of Position concerning the application of generally accepted auditing standards in auditing property and liability reinsurance and, for your review, we are attaching a copy of this Statement.

We at Guy Carpenter continue to place great emphasis on this issue and in recognition of our responsibilities in this area, have prepared the attached memorandum on Reinsurance Security for your information.

As you will note, the Statement of Position from the AICPA becomes effective for examinations made in accordance with generally accepted auditing standards for periods ending on or after December 31, 1983. We stand ready to assist you in reviewing the impact this Statement may have upon your current security practices and in undertaking steps

to comply with the procedures called for by the statement.

Very truly yours,

James C. Nelson III
Vice President

Auditing Standards Division

STATE OF POSITION

AUDITING PROPERTY AND LIABILITY REINSURANCE

Supplements Audits of Fire and Casualty Insurance Companies

October 1982

Prepared by the Reinsurance Auditing and Accounting Task Force
American Institute of Certified Public Accountants

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1211 Avenue of the Americans New York, NY 10009-8775

GUY CARPENTER & COMPANY, INC.

REINSURANCE SECURITY

As reinsurance intermediaries, we are not, of course, in a position to guarantee the security of any reinsurer; however, we do fully recognize our responsibilities to assist our clients by using good judgment in carefully reviewing each of the reinsurance markets with which we place business to be as certain as possible that they meet our clients' requirements. When we become aware of conditions which might jeopardize the ability of a reinsurer to respond to a loss, we take immediate action to ascertain the seriousness of the conditions, including direct discussions with the reinsurer when necessary, and advise our clients as promptly as possible. Our subsequent actions in such situations obviously depend on the outcome of our investigation and our clients' instructions.

In regard to business we place in the domestic market, each of our accounts people is instructed to exercise good judgement in the recommendation of markets, bearing in mind the size of the line being accepted in relation to the financial strength of the company. At the moment, we are endeavoring to utilize reinsurers with minimum

policyholders' surplus of $10,000,000 for companies accepting Property business, and $20,000,000 for those writing all reinsurance lines. In addition, a Best's Rating of "A" or better is normally required. These general criteria are based upon the current guidelines of our clients, and may vary with individual programs and client requests.

With respect to reinsurance we send to London for placement, this is either placed with Lloyd's Underwriters or other markets considered by our correspondents to be satisfactory.

We feel that this subject is of such great importance it requires a continuing review of all reinsurance security. We accomplish this by correspondence and periodic personal contact with each of the markets we use. However, by necessity, our efforts are limited to reviewing Carpenter placements, and, obviously, we are not always able to assess the potential impact on their book which might result from business they receive through other sources. For this reason, in order to collect and maintain current information on reinsurers, our Markets Reference Committee was formed in the New York office some years ago, and is presently comprised of thirteen senior officers of Guy Carpenter & Company. The Committee, which is scheduled to meet monthly, has

established procedures to record and monitor financial and other material information on all reinsurers with whom we are trading. The committee conducts an intensive review of each reinsurer presented as a new market. Periodic reassessments are undertaken to insure that certain minimum criteria continue to be met.

For instance, with respect to U. S. Markets, we obtain quarterly interim financial statements, the annual NAIC Convention Statement, the audited report to shareholders or other owners and the NAIC early warning test results. Starting in 1983, we will also request a copy of the most recent state insurance department examination, accountant's statement and loss reserve certification letter. In addition, we ascertain reinsurance underwriting philosophy and capacity, class of business responsibilities and retrocessional arrangements.

As part of its review, the Committee considers the following main points for each market in relation to industry norms:

1. The size of the company in terms of policyholders'

surplus or equivalent net worth.

2. The volume of gross and net premiums written in relation to net resources.

3. The amount of loss, loss adjustment expense and unearned premium reserves in relation to net resources and in relation to net premiums.

4. Underwriting performance and trends.

5. Mix of business.

6. Loss reserve development trends.

7. Investment portfolio with respect to liquidity, diversification and maturity.

8. Investment income in relation to gross premiums.

9. Analysis of cash flow from operations.

10. Loss Paying Margins - ability of the company to absorb an unusual shock.

11. Particular attention is devoted to trend analysis of underwriting and investment accounts over the current five years.

12. The management's record and reputation in the industry,

and the extent of the company's commitment to the reinsurance business.

In order to facilitate the collection of accurate information and disseminate it to our clients in an expedient manner, we have undertaken a program to store relevant key financial information in computer databases, and can provide our client with various financial exhibits in standard and custom formats. Additionally, we subscribe to timesharing databases which provide comprehensive financial data on U.S. and Canadian markets.

Extra precautions are taken with underwriting agencies, and they are subject to particularly close scrutiny where the agent's ownership is independent of the principal's. Ownership of the agency by the riskbearer(s) generally makes such market more acceptable. We attempt to secure a copy of the management agreement from the agent, verification of the appointment by the principal, and authorization to remit funds.

When dealing with markets outside the United States, Canada and London, our business is largely marketed through correspondent brokers, who are reputable and well-established firms in their respective areas. We make full use of the special knowledge of these correspondents in selecting and recommending reinsurance security, for they have additional insight into current activities and trends in the local marketplace. The correspondent's recommendation is always obtained before discussions with a client, so that the ultimate decision of a particular reinsurer can be made by the client on the strength of the best information available.

For these markets, we attempt to secure the most recent annual audited financial statement of each alien reinsurer, together with details of trusted funds available in the united States. We also utilize the NAIC Review of Alien Insurers, Insurance Solvency International (published by fox-Pitt Kelton) and International Insurance Financial Service.

Widely diverse accounting and disclosure standards, along with routine translation problems, often make it difficult to express alien reinsurers' financial statements in united States terms. Nonetheless, we

attempt to apply the tests above, together with correspondent's input and available data. Our objective is to maintain uniform security standards on a worldwide basis to the extent possible.

Our overseas marketing policy has always been conservative, and, we try to avoid involvement in any of the world's political or economic "volatile" areas.

Where a qualified national reinsurance broker is not available, as in Japan, we market our business directly, and we monitor the market situation through frequent visits. In Japan, we only use companies with a substantial policyholder surplus.

We believe it is essential that our client knows exactly where its reinsurance is placed, and fully accepts and approves its reinsurers. In placing a reinsurance program, we make every effort to use knowledgeable markets who already participate in other similar programs, and to spread the liability, rather than concentrate it with a few reinsurers who as a result could be subjected to shock losses. We have learned from experience that by following these principles with respect to

markets we can achieve the best standards of continuity and stability.

1/1/83

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF TENNESSEE
NASHVILLE DIVISION

CHEROKEE INSURANCE COMPANY,) by and through DAVID S. WEED, Special Deputy Commissioner of Commerce and Insurance for the Rehabilitation of Cherokee Insurance Company, Plaintiff,	)
v.	) Civil Action) No.3:90-0581) Judge Echols) Mag. Haynes
E.W. BLANCH CO., E.W. BLANCH, General Partner, MICHAEL W. CASHMAN, SR., General Partner, FRANK S. WILKINSON, General Partner, and PAUL S. MAVROS, General Partner, Defendants.	)

THIRD AFFIDAVIT OF BERNARD L. WEBB

I, BERNARD L. WEBB, having been duly sworn, deposes and says as follows:

1. I have previously submitted two (2) affidavits in this

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proceeding.

2. In Defendants' Memorandum of Law in Opposition to Plaintiff's Motion for Reconsideration, Blanch summarized my expert testimony to be "that Blanch should have applied a particular test (devised by myself) involving six financial ratios, when Blanch assessed reinsurers in 1980-1984". My expert testimony has never been and is not now as Blanch summarizes it. To properly summarize my expert testimony, I would state: (1) Blanch, being a reinsurance intermediary, involved in a relationship like the relationship existent between Blanch and Cherokee, had a duty to financially analyze and continually monitor the financial stability of the reinsurers with which is placed the ceding company's, namely Cherokee's business; (2) Based upon an in depth analysis of the annual financial statements of Mission, Transit and Mutual Fire, Blanch breached the foregoing duty; and, (3) at the time Blanch placed Cherokee's business with Mission, Transit and Mutual Fire, Blanch knew or should have known that these companies were financially impaired or that they were operating in such a manner that they were likely to become financially impaired. I have not nor do I anticipate testifying that Blanch needed to apply my exact ratios to

detect the financial instability of reinsurers.

3. The ratios I examine are just a few of many factors that may detect financial instability and inject the need for further investigation into the financial future of any reinsurance company. I have never held my ratios out as predictors of insolvency. In my opinion, there is no one group of ratios or factors that can predict the insolvency of reinsurance companies. However, there do exist several different ratios and factors to consider such as the ones I employ, that can educate and inform a reinsurance broker/intermediary as to a given reinsurer's possible financial pitfalls and consequently, dictate a more thorough examination. I do not, as alleged by Blanch, purport to have developed a test for predicting the failure of insurance or reinsurance companies.

4. Leo T. Heifetz, in his Second Affidavit, attacks the ratios I advocate as tools for detecting potential financial pitfalls of reinsurers as being unaccepted in the industry during the 1980 to 1984 time period and as being dysfunctional. His attack is, ironic since he at the same time states that Blanch was utilizing these tools during the 1980-1984 time period. One of my ratios (reinsurance commissions to policyholders

surplus) is very similar to IRIS Ratio 3 which Heifetz claims Blanch utilized. My ratios also include unearned premiums on reinsurance placed with nonaffiliates - an item also included in ratio 3. Furthermore, the ratio of unearned premium on reinsurance laced with nonaffiliates, would be reflected in an examination of retrocessional facilities which Heifetz claims Blanch did as well. My ratio of investments in subsidiaries deals with another factor Heifetz claims Blanch examined in arriving at reinsurers comprise Blanch's approved marketing list. And, finally, my ratio of agency balances to policyholders' surplus is very similar to IRIS Ratio 8, another ratio which according to Heifetz Blanch utilized. In summary, Blanch's attack on my ratios is nonsensical.

5. In its Response to Plaintiff's Motion for Reconsideration, Blanch mischaracterizes my testimony and attempted to discredit my ratios while at the same time admitting their use. As I have testified since the inception of this proceeding, if Blanch had prudently performed the financial analyses it is now claiming it performed, it would have recognized the financial instability of Mission, Transit and Mutual Fire and would not have, to Cherokee's detriment, chosen to utilize these companies as reinsurers of Cherokee's business.

AFFIANT FURTHER SAITH NOT.

S/ Bernard L. Webb

BERNARD L. WEBB

STATE OF GEORGIA)
) ss:
COUNTY OF FULTON)

SUBSCRIBED AND SWORN to before me by BERNARD L. WEBB on this the 29th day of September, 1992.

/S Dorothea McCloy

Notary Public

My Commission expires 2/9/95